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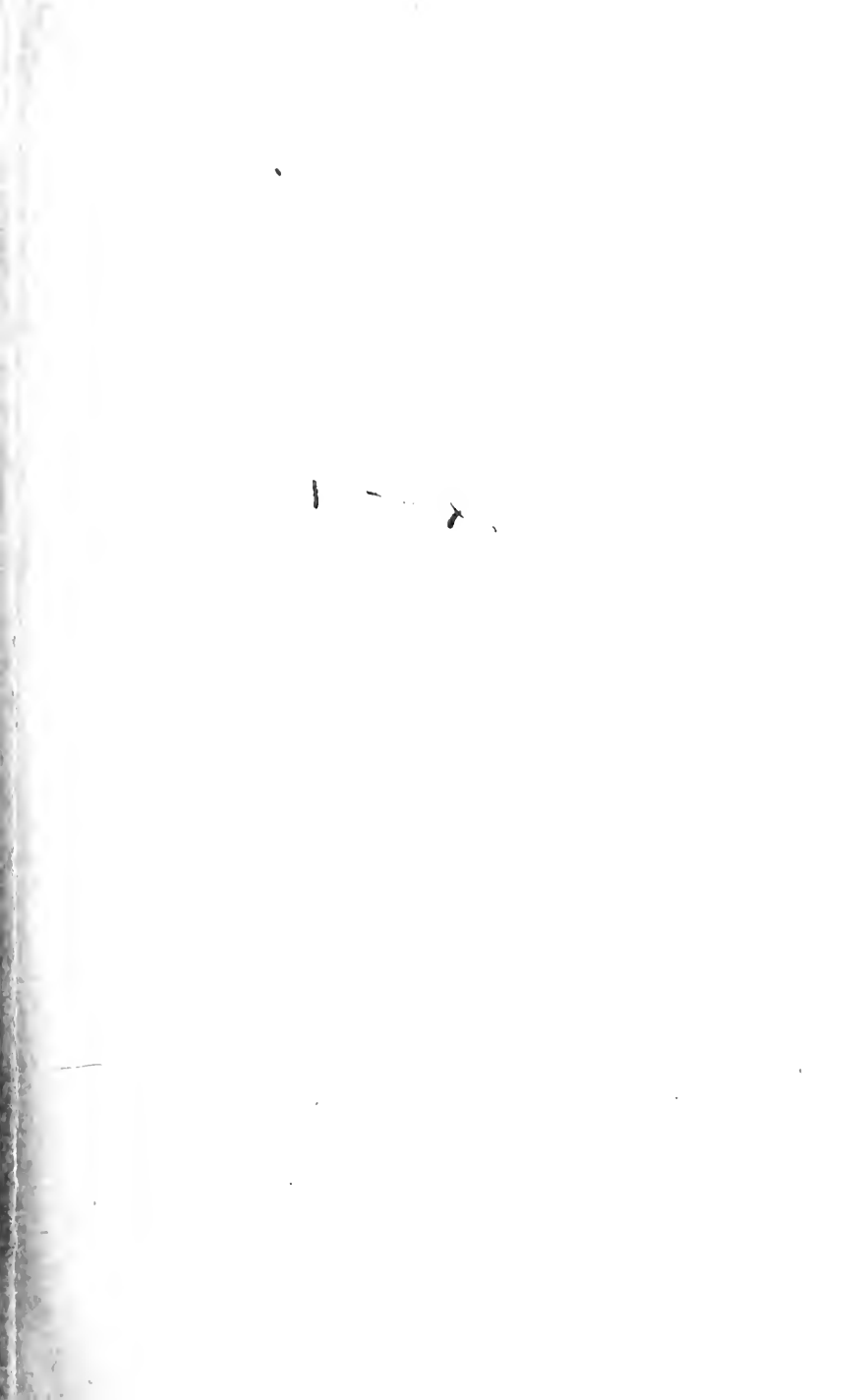
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No. 11160

15,2436

United States  
Circuit Court of Appeals  
For the Ninth Circuit.

BABETTE G. LURIE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

Transcript of the Record

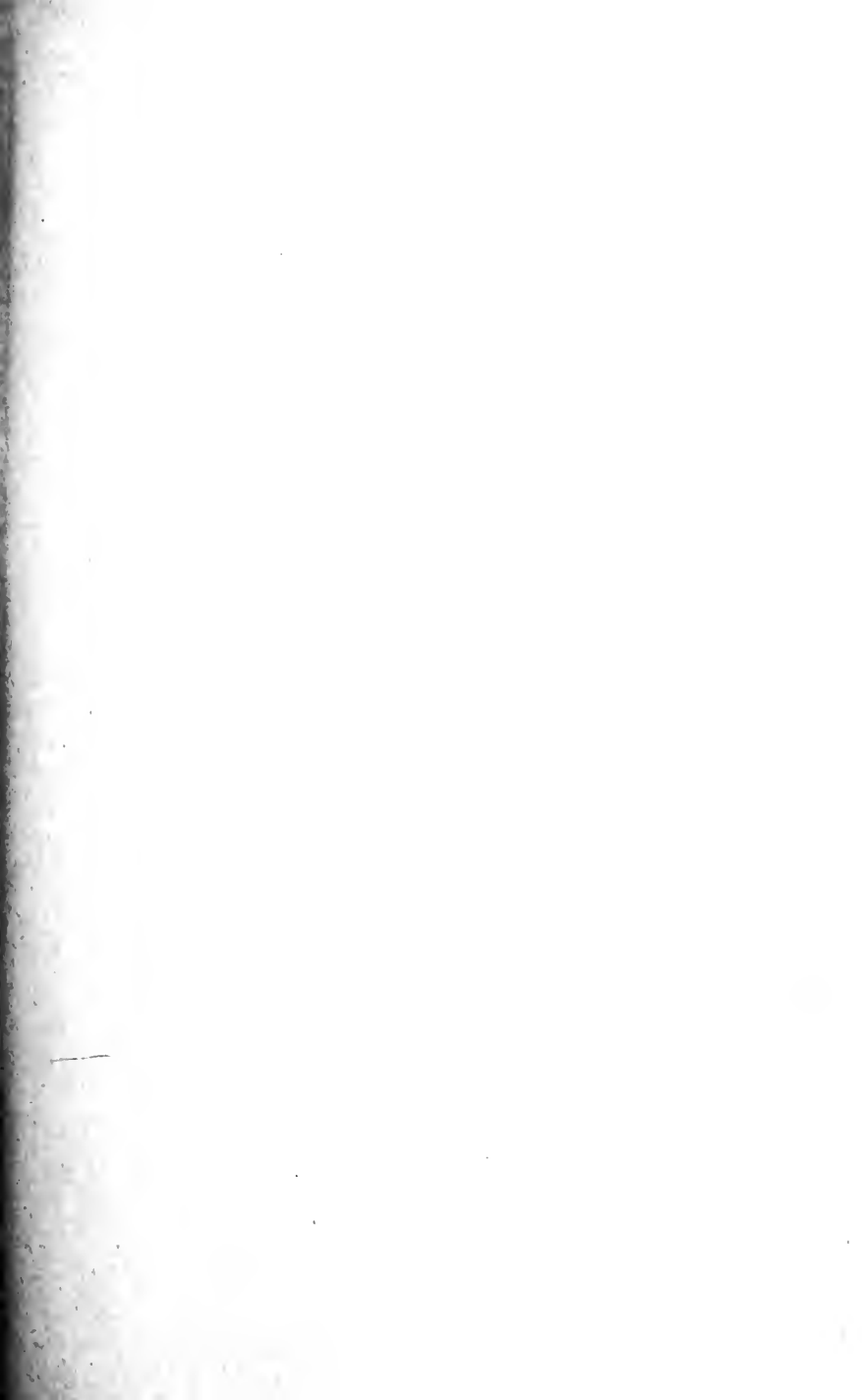
Upon Petition to Review a Decision of the Tax Court  
of the United States

FILED

NOV 30 1945

PAUL P. O'BRIEN,  
CLERK









No. 11160

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United States  
Circuit Court of Appeals  
For the Ninth Circuit.

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BABETTE G. LURIE,

Petitioner,

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COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

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Transcript of the Record

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Upon Petition to Review a Decision of the Tax Court  
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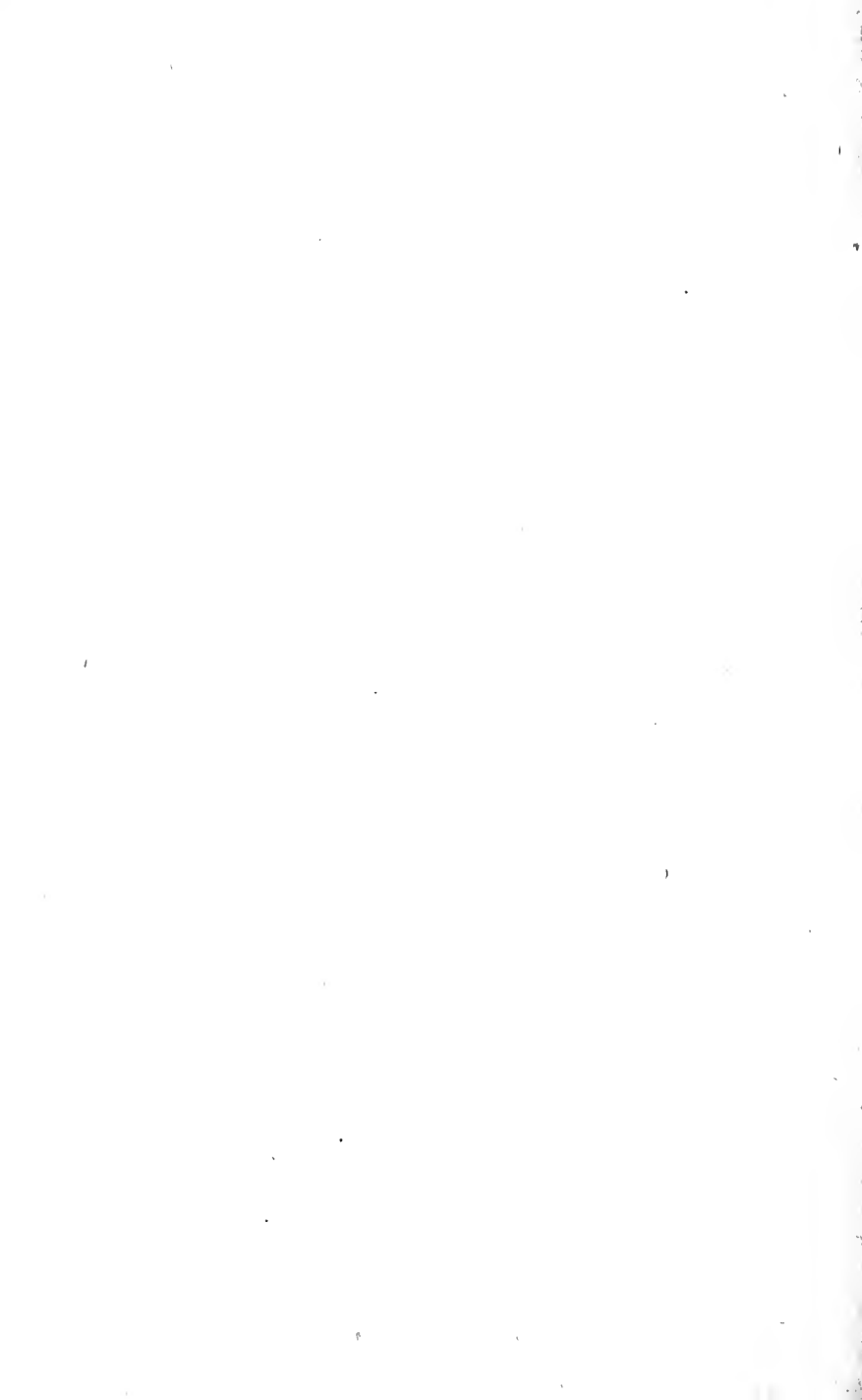


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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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## APPEARANCES:

For Taxpayer:

OSCAR SAMUELS, ESQ.,

TEVIS JACOBS, ESQ.

For Comm'r:

T. M. MATHER, ESQ.

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Docket No. 3571

BABETTE G. LURIE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

## DOCKET ENTRIES

1943

Dec. 6—Petition received and filed. Taxpayer notified. Fee paid.

Dec. 6—Request for Circuit hearing in San Francisco, California, filed by taxpayer, 12/10/43 Granted.

Dec. 7—Copy of petition served on General Counsel.

1944

Jan. 12—Answer filed by General Counsel.

Jan. 14—Copy of answer served on taxpayer. San Francisco, California.

1944

Aug. 10—Hearing set Sept. 18, 1944, in San Francisco, California.

Sep. 18—Hearing had before Judge Van Fossan on merits. Consolidated with 3572. Stipulation of facts filed. Briefs due Nov. 2, 1944. Replies November 17, 1944.

Oct. 14—Transcript of hearing 9/18/44 filed.

Oct. 25—Brief filed by General Counsel.

Oct. 26—Brief filed by taxpayer. 10/26/44 Copy served.

Nov. 14—Reply brief filed by taxpayer. Copy served.

1945

Mar. 31—Findings of fact and opinion rendered, Judge Van Fossan. Decision will be entered for the respondent. 4/2/45 Copy served.

Mar. 31—Decision entered. Judge Van Fossan. Div. 9.

Jun. 16—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by taxpayer.

Jun. 30—Proof of service filed.

Sep. 19—Designation of contents of record filed by taxpayer with proof of service thereon.

Sep. 24—Certified copy of order from Circuit Court of Appeals, 9th Circuit, extending time to October 15, 1945, filed. [1\*]

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\*Page numbering appearing at top of page of original certified Transcript.



The Tax Court of the United States

Docket No. 3571

BABETTE G. LURIE,

Petitioner.

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent,

PETITION

The above named Petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (San Francisco Division, IRA:90-D-WLS, (C:TS:PD SF:BMG)), dated October 22, 1943, and as a basis of her proceeding alleges as follows:

1. Petitioner is a resident of San Francisco, California, with her office at 333 Montgomery Street, San Francisco, California. The return for the period here involved was filed by Petitioner with the Collector for the First District of California, at San Francisco.

2. The Notice of Deficiency (a copy of which is attached hereto and marked Exhibit "A") was mailed to Petitioner on October 22, 1943.

3. The taxes in controversy are income taxes for the year ending December 31, 1941, and are in the amount of \$1,177.03.

4. The determination of tax set forth in said

Notice of Deficiency is based upon the following error: [2]

(a) A gain of \$3,448.53 from the retirement of preferred income notes of Hilton Hotel Company of California was held to be ordinary income instead of a long-term capital gain.

5. The facts upon which Petitioner relies as a basis of this proceeding are as follows:

(a) During the year 1939 Petitioner and Louis R. Lurie, husband of Petitioner, in equal shares purchased various securities of Hilton Hotel Company of California, including the stock of said corporation, bonds of said corporation, and preferred income notes issued by said corporation. Said preferred income notes were payable out of the income of the corporation as defined in each note so issued. The total amount of the issue was \$203,747.94, and said notes were issued pursuant to a permit of the Division of Corporations of the State of California.

(b) In 1940 Petitioner's husband and the other holders of said series of notes returned said notes to Hilton Hotel Company of California and on the face of said notes was printed the following:

“Notice to Holder: This note may be registered as provided on the back hereof.”

and upon the reverse of said notes was printed the following:

“This note may be registered in the holder's name upon a register to be maintained by the Company at its office in San Francisco, Califor-

nia. Such registration shall be noted on this note by the Company, after which no transfer hereof shall be valid unless made on said register and noted on this note. The Company may deem and treat the person in whose name this note is from time to time registered as the absolute owner hereof for the purpose of receiving payments of principal and interest due hereon and for all other purposes.

(Registration)

Notice to Holder: Do not write on this note. Consult [3] the Company for method of transferring registration. Date of Registry In Whose Name Registered: Register, Hilton Hotel Company of California.

By .....  
Authorized Officer."

Immediately following said change to registered form, said notes, including those owned by Petitioner, were in fact registered in a register maintained by said corporation in its office in San Francisco, California, and the date of such registration (August 6, 1940), the name of Petitioner's husband, and the signature of the authorized officer of said corporation were inscribed on each note.

(c) In 1941 all of said notes were retired and Petitioner and her husband received \$6,897.06 in excess of the cost to them of said notes and one-half thereof, or \$3,448.53, was reported by Petitioner as a long-term capital gain (and the other

one-half of said excess was reported by Petitioner's said husband).

Wherefore, Petitioner prays that this Court may hear the proceeding and determine that there is no deficiency due from the Petitioner for the year ending December 31, 1941.

Dated: San Francisco, California, November 30th, 1943.

OSCAR SAMUELS,  
TEVIS JACOBS,

Counsel for Petitioner. [4]

State of California,

City and County of San Francisco—ss.

Babette G. Lurie, being first duly sworn, deposes and says:

That she is the Petitioner named in the foregoing Petition; that she has read said petition and knows the contents thereof; that the same is true of her own knowledge except as to the matters therein stated on information or belief, and as to those matters that she believes it to be true.

BABETTE G. LURIE.

Subscribed and sworn to before me this 30th day of November, 1943.

[Seal] HELEN V. FLANAGAN,  
Notary Public in and for the City and County of  
San Francisco, State of California.

My commission expires January 24, 1945. [5]

EXHIBIT "A"

SN-IT-1

Treasury Department  
Internal Revenue Service  
74 New Montgomery Street.  
San Francisco 5, California

Oct. 22, 1943

Office of  
Internal Revenue Agent  
in Charge

San Francisco Division  
IRA:90-D-WLS  
(C:TS:PD  
SF:GMB)

Mrs. Babette G. Lurie,  
333 Montgomery Street,  
San Francisco, California

Madam:

You are advised that the determination of your income tax liability for the taxable year(s) ended December 31, 1941 discloses a deficiency of \$1,177.03 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the Tax Court of the United States for a redetermination of the deficiency.

Should you not desire to file a petition, you are

requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, San Francisco, California, for the attention of Conference Section. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

ROBERT E. HANNEGAN,  
Commissioner.

(Signed) By F. M. HARLESS,  
Internal Revenue Agent in  
Charge.

Enclosures:

Statement.

Form of waiver. [6]

### STATEMENT

San Francisco  
IRA :90-D-WLS  
(C:TS:PD  
SF:GMB)

Mrs. Babette G. Lurie,  
333 Montgomery Street,  
San Francisco, California

Tax Liability for the Taxable Year Ended  
December 31, 1941

	Liability	Assessed	Deficiency
Income Tax	\$15,810.38	\$14,633.35	\$1,177.03



In making this determination of your income tax liability, careful consideration has been given to your protest dated July 15, 1943; to the statements made at the conferences held on August 3 and September 22, 1943.

A copy of this letter and statement has been mailed to your representatives, Oscar Samuels and Tevis Jacobs, 333 Montgomery Street, San Francisco, California, in accordance with the authority contained in the power of attorney executed by you and on file in this office.

#### Adjustments to Net Income

Net income as disclosed by return	\$49,186.29
Unallowable deductions and additional income:	
(a) Gain on retirement of notes	1,724.26
	<hr/>
Net income adjusted	\$50,910.55

#### Explanation of Adjustments

(a) You reported a gain of \$3,448.53 from the retirement of preferred income notes of the Hilton Hotel Company of California. This gain was returned as a long-term capital gain, 50% or \$1,724.27 thereof being taken into account in computing taxable income.

The gain in the sum of \$3,448.53 realized upon the retirement of preferred income notes is held to be ordinary income taxable in the full amount thereof. Accordingly, the unreported portion of the gain is added to taxable income.

## COMPUTATION OF ALTERNATIVE TAX

(Section 117 (c)—I. R. C.)

Net income	\$50,910.55
Minus: Net long-term capital gain	23,609.48
Ordinary net income	<u>\$27,301.07</u>
Less:	
Personal Exemption (claimed by husband)	None
Balance (surtax net income)	<u>\$27,301.07</u>
Less:	
Earned income credit	1,400.00
Net income subject to normal tax	<u>\$25,901.07</u>
Normal tax at 4 per cent on \$25,901.07	\$ 1,036.04
Surtax on \$27,301.07	7,691.50
Partial tax	<u>\$ 8,727.54</u>
Plus: 30 per cent of net long-term gain	7,082.84
Alternative tax	<u>\$15,810.38</u>

## COMPUTATION OF TAX

Net income adjusted	\$50,910.55
Less:	
Personal exemption	None
Balance (surtax net income)	<u>\$50,910.55</u>
Less:	
Earned income credit	1,400.00
Net income subject to normal tax	<u>\$49,510.55</u>
Normal tax at 4% on \$49,510.55	\$ 1,980.42
Surtax on \$50,510.55	19,899.01
Total tax	<u>\$21,879.43</u>
Total alternative tax	<u>\$15,810.38</u>

Correct income tax liability	\$15,810.38
Income tax assessed:	
Original, account No. 327476—First California	14,633.35
	<hr/>
Deficiency of income tax	\$ 1,177.03

[Endorsed]: T.C.U.S. Filed Dec. 6, 1943. [9]

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[Title of Tax Court and Cause.]

### ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. (a) Denies that the Commissioner erred in the determination of the deficiency, as alleged in subparagraph (a) of paragraph 4 of the petition.

5. (a) Admits that during the year 1939 petitioner and Louis R. Lurie, husband of petitioner, purchased preferred income notes issued by Hilton Hotel Company of California, but denies the

remaining allegations contained in subparagraph (a) of paragraph 5 of the petition.

(b) For lack of information denies the allegations contained in subparagraph (b) of paragraph 5 of the petition.

(c) Admits the allegations contained in subparagraph (c) of paragraph 5 of the petition.

6. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified, or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

[Signed]                      J. P. WENCHEL, TMM,  
   Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,  
                                 Division Counsel.

T. M. MATHER,  
                                 Attorney, Bureau of Internal Revenue.

TMM/vg 12-30-43.

[Endorsed]: T.C.U.S. Filed Jan. 12, 1944. [11]

The Tax Court of the United States

4 T. C. No. 126

BABETTE G. LURIE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

LOUIS R. LURIE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Docket Nos. 3571, 3572

Promulgated: March 31, 1945.

Preferred income notes issued originally without registration, were duly registered in August, 1940, and retired in 1941.

Held, that to qualify under section 117 (f), Revenue Act of 1938, the securities retired must have been in registered form for at least the minimum period of 18 months provided by section 117 (b).

Tevis Jacobs, Esq., for the petitioners.

T. M. Mather, Esq., for the respondent.

The respondent determined a deficiency of \$1,517.34 in the income tax of the petitioner, Louis R. Lurie, for the year 1941, and \$1,177.03 in the income tax of the petitioner, Babette G. Lurie, for the same year.

The sole issue is whether a gain of \$3,448.53 realized by each [12] petitioner upon the retirement of preferred income notes of Hilton Hotel Company of California constituted capital gain or ordinary income.

### FINDINGS OF FACT

The facts were stipulated. Insofar as they are material to the issue, they are as follows:

The petitioners, Louis R. Lurie and Babette G. Lurie, are husband and wife and reside in San Francisco, California. They filed their income tax returns for the year 1941 with the collector of internal revenue for the first district of California.

In 1938 the Hilton Hotel Company of California (then known as Huckins-Newcomb Hotel Company), hereinafter called the company, had outstanding various stock, bonds, notes and other obligations. A group of individuals, including the petitioners, acquired all of such securities and obligations. In order to facilitate the handling of them, units were formed, consisting of an equal percentage of all of the securities and obligations. Thereupon, pursuant to permits of the Commissioner of Corporations of the State of California, each member of the group received voting trust certificates, promissory notes and other securities in proportion to the number of units held by him. Included was a series of preferred income notes in the total amount of \$203,747.94, issued pursuant to a permit of the Commissioner of Corporations. Each note was a printed document containing no reference to registration.

At the time of the original issuance of the notes, the petitioners jointly owned approximately one-third of the units and therefore owned one-third of the outstanding securities, including one-third of the total [13] amount of the preferred income notes. Shortly thereafter, late in the year 1938 and early in 1939, the petitioners acquired additional units and included in each were preferred income notes which were acquired at less than face value and which are involved herein. After the acquisition of these additional units, the petitioners owned slightly in excess of forty per cent of the units.

The voting trustees in the voting trust certificates included in the units consisted of the petitioner Louis R. Lurie, C. N. Hilton and Don B. Burger, the last named being an owner of a small number of voting trust certificates and prior preferred income notes and an employee of C. N. Hilton. The remaining voting trust certificates and prior preferred income notes (and other securities of the corporation in the same proportion) were owned by C. N. Hilton and various associates of his who at all times controlled the company and whose attorney was employed as attorney for the company. The directors of the company consisted of Louis R. Lurie, his auditor J. A. Kurzman, C. N. Hilton, Don B. Burger and one Packey Dee of Chicago.

In the application for the permit to issue the promissory notes, it is recited: "Said new promissory notes are to be registered and applicant hereby designates itself to act as the registrar thereof." Annexed to the application was a printed form of

a preferred income note and there was an additional printed page entitled "Registration," on which was set forth a form for registering the notes. When the notes were finally printed and issued, the page entitled "Registration" was omitted. In August of 1940, the company requested of the holders of the notes that they be returned to it. [14]

The notes were thereupon returned to the company and on the face of each of the notes was printed the following:

"Notice to Holder: This not may be registered as provided on the back hereof."

and on the back of each was printed the following:

"This note may be registered in the holder's name upon a register to be maintained by the Company at its office in San Francisco, California. Such registration shall be noted on this note by the Company, after which no transfer hereof shall be valid unless made on said register and noted on this note. The Company may deem and treat the person in whose name this note is from time to time registered as the absolute owner hereof for the purpose of receiving payments of principal and interest due hereon and for all other purposes.

(Registration)

Notice to Holder: Do not write on this note. Consult the Company for method of transferring registration.

Date of Registry: In Whose Name Registered:  
Register Hilton Hotel Company of California.

By .....  
Authorized Officer."



On August 6, 1940, the petitioners returned to the company the notes involved herein and had them registered in the name of Louis R. Lurie, one of the petitioners. A photostatic copy of one of the original notes, after registration, is in the record and reference is here made to it.

For the year 1940 the taxpayers returned the profit on the principal payments made on account of the notes in that year after registration as a capital gain and the Internal Revenue Department held it to be ordinary income. The petitioners acceded to the contention of the department on advice of counsel that, regardless of whether or not the notes were in registered form, the notes were not retired in the [15] year 1940 as required by section 117 (f) of the Revenue Act in order to fall within its terms.

All of the notes in question were retired in 1941, more than two years after the acquisition of them by the petitioners and less than 18 months after the date that the notes were returned to the company and registered as aforesaid, at a profit to each of the petitioners in the amount of \$3,448.53. This profit was returned by each of the taxpayers as a capital gain. The respondent determined that such profit was ordinary income.

### OPINION

Van Fossan, Judge: There is, and can be, no question raised as to the fact that the notes here in question were capital assets under the statutory definition of section 117 (a) (1). The issue arises

solely from the fact that the notes were not in registered form when originally issued, formal registration or registered endorsement on the backs of the notes not being perfected until August 6, 1940, less than 18 months before retirement.

The problem being one of statutory interpretation, we look first to the legislative history. Antedating section 117 (f) were the cases of Henry P. Werner, 15 B.T.A. 482, and John H. Watson, Jr., 27 B.T.A. 463. In the Werner case the Board of Tax Appeals held that gain realized when certain bonds were retired and called prior to maturity was a gain on the "sale or exchange" of a capital asset within the meaning of section 206 of the Revenue Act of 1921, reversing the practice of the Bureau of Internal Revenue as laid down in I. T. 1637. After the promulgation of the Werner case, the Bureau, by I. T. 2488, adopted the doctrine of that case. [16]

In John H. Watson, Jr., *supra*, we re-examined the question under an identical statutory provision of the Revenue Act of 1928 and on such reconsideration reversed the ruling of the Werner case and held that the payment of an amount specified in a bond, either at maturity or pursuant to an authorized call prior to maturity, is not a "sale or exchange" of such bond under section 101 (c) (2) of the Revenue Act of 1928. We specifically disapproved I. T. 2488. See *Fairbanks v. United States*, 306 U. S. 436.

Thereafter Congress, in the Revenue Act of 1934, embraced the holding of the Werner case and

adopted section 117 (f)<sup>1</sup> which has persisted in subsequent acts and the Internal Revenue Code.

Addressing ourselves to the specific phase of the question before us, we may note that we have examined the Congressional reports without gleaming any help in our problem.

Petitioners make two contentions, (1) that the notes were in registered form when retired and that this is sufficient compliance with the statute, and (2) that the notes were capital assets, held for more than two years and, therefore, on retirement, profit constituted long-term capital gain regardless of the fact that they were not in registered form for the statutory period. Respondent contends that when properly read section 117 (f) requires that securities be in [17] registered form at the time of issuance and subsequent registration is insufficient. He argues, alternatively, that since registration occurred in August, 1940, and retirement in 1941, petitioners did not hold the notes in registered form for the period of 18 months required by section 117 (b)<sup>2</sup>.

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<sup>1</sup>Sec. 117. Capital Gains and Losses.

(f) Retirement of Bonds, Etc.—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

<sup>2</sup>(b) Percentage Taken Into Account.—In the case of a taxpayer other than a corporation, only the following percentages of the gain or loss rec-

As to petitioners' first contention that if the notes were in registered form at the time of retirement the statute was satisfied, we have not the slightest doubt that this was not the Congressional intent. Such a last-minute registration just before retirement, even after the call for retirement has been issued, would permit the holders of notes or other securities to determine for themselves, in accord with their individual advantage, the tax consequences that would flow from retirement without regard for uniformity of treatment or the interests of the Government. The suggested interpretation seems contrary to the whole basic concept of section 117 (f).

The second contention is equally untenable. They argue that the notes were capital assets, held for more than two years, and that therefore it is immaterial that they were not in registered form for the minimum period provided by section 117 (b). The fault of this [18] argument is that in the absence of section 117 (f) the ruling of this Court in *John H. Watson, Jr.*, and cases to the same effect, would be operative and it would, of necessity, be held that albeit the notes were capital assets, there

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ognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 18 months;

66 2/3 per centum if the capital asset has been held for more than 18 months but not for more than 24 months;

50 per centum if the capital asset has been held for more than 24 months.

was no sale or exchange of such notes on retirement. Section 117 (f) superseded the above ruling but it did not invalidate or reverse the principles underlying, or the logic of, that decision. Thus it is, if petitioners are to prevail, the case must be held to come within the provisions of section 117 (f).

Although we find ourselves in disagreement with both the petitioners' contentions, we do not, under the facts, find it necessary in these cases to approve respondent's main contention that the notes must be in registered form from the time of issuance and that no subsequent registration can convert unregistered notes into notes in registered form. Rather, we find in respondent's alternative argument sufficient basis for our ruling that since petitioners' notes were not in registered form for the minimum period fixed by section 117 (b), i.e., 18 months, they cannot be held to satisfy section 117 (f).

In our opinion there can be no doubt that, taking all the provisions of section 117 into consideration and having due regard for the purposes of the section, to come within section 117 (f) the notes must be, at the very least, in registered form for the minimum period provided by section 117 (b). This period is 18 months. Since petitioners' notes were in registered form for less than such period before retirement, they do not qualify under section 117 (f).

Reviewed by the Court.

Decisions will be entered for the respondent.

Kern, J., concurs only in the result.

The Tax Court of the United States  
Washington

Docket No. 3571

BABETTE G. LURIE,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

### DECISION

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion promulgated March 31, 1945, it is

Ordered and Decided: That there is a deficiency in income tax for the calendar year 1941 in the amount of \$1,177.03.

[Seal] (Signed) ERNEST H. VAN FOSSAN  
Judge.

Entered Mar. 31, 1945. [20]

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[Title of Tax Court and Cause.]

### PETITION FOR REVIEW BY THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

To the Honorable the Judges of the United States  
Circuit Court of Appeals for the Ninth Circuit:

Babette G. Lurie, your petitioner, respectfully petitions this Honorable Court to review the decision

of The Tax Court of the United States entered in the above entitled cause on the 31st day of March, 1945, and determining a deficiency in income tax for the calendar year 1941 in the amount of \$1177.03.

## I.

### Jurisdiction

Your petitioner is a resident of the City and County of San Francisco, State of California. [21]

The return of income taxes for the period here involved was filed with the Collector of Internal Revenue, 1st District, in the City and County of San Francisco, State of California, which is located within the jurisdiction of the Circuit Court of Appeals for the Ninth Judicial Circuit.

Jurisdiction of this court to review the afore-said decision of The Tax Court of the United States is founded on Internal Revenue Code Sections 1141 (a) (b) (1).

## II.

### Nature of Controversy

The petitioner, on the 6th day of December, 1943, filed with The Tax Court of the United States a petition requesting a redetermination of a deficiency set forth by the Commissioner of Internal Revenue in a notice of deficiency (San Francisco Division, IRA:90-D-WLS (C:TS:PD SF:GMB) ), dated October 22, 1943, in the amount of \$1177.03 in income taxes for the calendar year 1941.

The issue to be determined by The Tax Court of the United States was as follows:

When preferred income notes not in registered form of a series issued by a corporation are purchased by an individual taxpayer at less than face value and all of the outstanding notes are thereafter returned to the corporation to permit of a form of registration being printed on each and [22] the registration thereof, is the profit on retirement of said notes a long term capital gain under the law as it existed in 1941 when the retirement occurred more than two years after acquisition of said notes by the taxpayer although less than 18 months after registration?

The case was heard before the Honorable Ernest H. Van Fossan at San Francisco, California, on September 18, 1944.

### III.

#### Declaration of the Court in Which Review Is Sought

Said petitioner being aggrieved by the findings of fact and opinion promulgated by The Tax Court of the United States on March 31, 1945, in the above entitled matter, and by its decision entered pursuant thereto, desires to obtain a review thereof by the United States Circuit Court of Appeals for the Ninth Circuit, petitioner being a resident of the City and County of San Francisco, State of California, and having filed her income tax return for the calendar year 1941 with the Collector of Internal Revenue at San Francisco, California.



IV.

ASSIGNMENTS OF ERROR

The petitioner assigns as error the following:

1. The determination by The Tax Court of the United States that petitioner was not entitled to return the [23] profit on the retirement of certain preferred income notes as a long term capital gain.

2. The determination by said Court that said notes were required to be in registered form for a period of at least 18 months in order for the retirement to constitute an exchange under Section 117 (f) of the Internal Revenue Code.

OSCAR SAMUELS

TEVIS JACOBS

Attorneys for Petitioner.

[Endorsed]: T.C.U.S. Filed June 16, 1945. [24]

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[Title of Tax Court and Cause.]

NOTICE OF FILING PETITION FOR  
REVIEW

To the Chief Counsel of the Bureau of Internal Revenue, Washington, D. C.

Please Take Notice that the petitioner, on the 16th day of June, 1945, filed with the Clerk of The Tax Court of the United States, her petition for a review by the United States Circuit Court of Appeals for the Ninth Circuit of the decision of The Tax Court

of the United States heretofore rendered in the above entitled cause.

A copy of the petition for review as filed is hereto attached and served upon you.

San Francisco, California

June 15, 1945.

/s/ OSCAR SAMUELS

/s/ TEVIS JACOBS

Attorneys for Petitioner [25]

Receipt of a Copy of the foregoing Notice and the attached Petition is hereby acknowledged this 18th day of June, 1945.

/s/ J. P. WENCHEL (CAR)

Chief Counsel

Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed June 30, 1945. [26]

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[Title of Tax Court and Cause—Nos. 3571-3572.]

### STIPULATION OF FACTS

It Is Hereby Stipulated by and between the parties hereto as follows:

1. Taxpayers Louis R. Lurie and Babette G. Lurie are husband and wife, and each filed a separate return for the year ending December 31, 1941.

2. In 1938 the Hilton Hotel Company of California, then known as Huckins-Newcomb Hotel Company, had outstanding various stock, bonds,

notes and other obligations. A group of individuals, including the taxpayers, acquired all of said securities and obligations. [27] In order to facilitate the handling of them, units were formed, consisting of an equal percentage of all said securities and obligations. Thereupon, pursuant to permits of the Commissioner of Corporations of the State of California, each member of the group received voting trust certificates, promissory notes and other securities in proportion to the number of units held by him. Included was a series of preferred income notes in the total amount of \$203,747.94, issued pursuant to a permit of the Commissioner of Corporations. Each of said notes was a printed document, a typewritten copy of which is annexed hereto and marked Exhibit 1.

3. At the time of the original issuance of said notes, taxpayers jointly owned approximately one-third of the units and therefore owned one-third of the outstanding securities including one-third of the total amount of said preferred income notes. Shortly thereafter, in the year 1938 and early in 1939, taxpayers acquired additional units and included in each were preferred income notes which notes were acquired at less than face value and which are the subject of the instant case. After the acquisition of these additional units, the taxpayers owned slightly in excess of forty per cent of said units. The voting trustees in the voting trust certificates included in said units consisted of taxpayer Louis R. Lurie, C. N. Hilton and Don B. Burger, the latter being an owner of a small number of voting

trust certificates and prior preferred income notes and an employee of C. N. Hilton. The remaining voting trust certificate and prior preferred income notes (and other securities of the corporation in the same proportion) were owned by C. N. Hilton and various associates of his who at all times controlled the corporation and whose attorney was employed as attorney for said corporation. The [28] directors of said corporation consisted of Louis R. Lurie, his auditor J. A. Kurzman, C. N. Hilton, Don B. Burger and one Packey Dee of Chicago.

4. In the application for the permit to issue said promissory notes, it is recited: "Said new promissory notes are to be registered and applicant hereby designates itself to act as the registrar thereof." Annexed to said application was a printed form of a preferred income note as in Exhibit 1 hereof, and there was an additional printed page entitled "Registration", on which was set forth a form for registering said notes. When said notes were finally printed and issued, they were in the form of Exhibit 1. In August of 1940, the Company requested of the holders of said notes that they be returned to it. The notes were thereupon returned to the Company and on the face of each of said notes was printed the following:

"Notice of Holder: This note may be registered as provided on the back hereof."

and on the back of each was printed the following:

"This note may be registered in the holder's name upon a register to be maintained by the Company

at its office in San Francisco, California. Such registration shall be noted on this note by the Company, after which no transfer hereof shall be valid unless made on said register and noted on this note. The Company may deem and treat the person in whose name this note is from time to time registered as the absolute owner hereof for the purpose of receiving payments of principal and interest due hereon and for all other purposes.

(Registration)

Notice to Holder: Do not write on this note. Consult the Company for method of transferring registration.

Date of Registry.

.....

In Whose Name Registered.

.....

Register Hilton Hotel Company of California

By .....

Authorized Officer" [29]

5. On August 6, 1940, the taxpayers returned to said corporation the notes involved in this action and had them registered in the name of Louis R. Lurie, one of the taxpayers herein. A photostatic copy of one of said notes is annexed hereto and marked Exhibit 2.

6. For the year 1940 the taxpayers returned the profit on the principal payments made on account of

said notes in said year after registration as a capital gain and the Internal Revenue Department held the same to be ordinary income. The taxpayers acceded to the contention of the department on advice of counsel that, regardless of whether or not the notes were in registered form, said notes were not retired in the year 1940 as required by section 117 (f) of the Revenue Act in order to fall within its terms.

7. All of the notes in question were retired in 1941, more than two years after the acquisition of them by the taxpayers and less than eighteen months after the date that said notes were returned to the Company and registered as aforesaid, at a profit in the instance of each of the taxpayers in the amount of \$3,448.43. This profit was returned by each of the taxpayers as a capital gain and the respondent contends that said profit is ordinary income.

Dated: September 14, 1944.

OSCAR SAMUELS

TEVIS JACOBS

Attorneys for Petitioners

J. P. WENCHEL (TMM)

Chief Counsel

Bureau of Internal Revenue

Attorneys for Respondent

## EXHIBIT 1

## Hilton Hotel Company of California

## PREFERRED INCOME NOTE

No..... \$......

Know All Men by These Presents, That Hilton Hotel Company of California, a corporation duly organized and existing under and by virtue of the law of the State of California, hereinafter referred to as the "Company", acknowledges itself to owe and for value received promises to pay to.....  
.....or order, the principal sum of.....  
.....Dollars (\$.....) on or before November 1, 1952, with interest on said principal sum from the date hereof until maturity, at the rate of six per cent (6%) per annum, payable on November 1, 1938, and thereafter semiannually on the first days of May and November of each year until maturity; provided, however, that such interest shall be payable only out of the available cash receipts of the Company as hereinafter defined, for the operating period preceding each semiannual interest payment date, if and to the extent that such available cash receipts shall be sufficient for such payment.

If interest so paid shall be less than at the rate of six per cent (6%) per annum on this note, the difference between the amount equal to interest for any semiannual period immediately preceding any semiannual interest payment date at the rate of six per cent (6%) per annum and the amount of interest paid for such semiannual period, shall accumulate but without interest on such accumulated in-

terest, until from and after November 1, 1952. In the event that available cash receipts for any operating period immediately preceding any semiannual interest payment date shall not be sufficient to pay interest at the rate of six per cent (6%) per annum for such period, such available cash receipts as are available for such period shall be distributed proportionately to the holders of notes of the series of which this note is one. In the event available cash receipts for any operating period are more than sufficient to pay current interest on said notes, together with all accumulated interest thereon, if any, the Company covenants to apply the excess of such available cash receipts, on the next interest payment date, toward the payment of the principal of said notes. The principal of and accumulated interest on this note shall, after November 1, 1952, bear interest unconditionally at the rate of six per cent (6%) per annum until paid. Interest shall not be paid on accumulated interest until the maturity of this note and then only from and after such maturity.

All payments of principal and interest shall be paid in lawful money of the United States of America at the office of the Company, in the City and County of San Francisco, State of California, and shall be made proportionately to all holders of notes of this series.

This note is one of a series of notes of the Company known as "Hilton Hotel Company of California Preferred Income Notes", limited in the aggregate to the principal sum of Two Hundred Three



Thousand Seven Hundred Forty-seven and 94/100 Dollars (\$203,747.94). [31]

The term "operating period" as used in this note is defined to mean each six (6) months period ending September 30 and March 31 of each year beginning with the six (6) months period ending September 30, 1938. The term "available cash receipts" as used in this note is hereby defined to mean the gross cash receipts of the Company from all sources received during each operating period less, for such operating period, (a) all of the Company's operating expenses, which term shall mean and embrace all costs, charges, outlays and payments made in connection with or for materials, supplies, merchandise, advertising, repairs, ordinary and current replacements, services, salaries, wages and (except as to undertakings secured by the New First Deed of Trust, the New First Chattel Mortgage, the New Second Deed of Trust, the New Second Chattel Mortgage and by that certain Second Supplemental Indenture, dated as of January 1, 1938, executed by the Company and Crocker First National Bank of San Francisco, and certain bondholders, and recorded on June 17, 1938 in Volume 3291 of Official Records at page 331, in the office of the Recorder of the City and County of San Francisco, State of California, said New First Deed of Trust, said New First Chattel Mortgage, said New Second Deed of Trust and said New Second Chattel Mortgage being described in said Second Supplemental Indenture) interest upon and principal of its obligations heretofore or hereafter contracted in good faith in pursuit of the Com-

pany's corporate purposes (except principal and interest on the notes of the series of which this is one), not including, however, any indebtedness to the Company's stockholders which existed on May 1, 1932, or any renewal of such indebtedness; (b) disbursements for necessary improvements and alterations to the property of the Company, ordinarily chargeable to capital, not exceeding in the aggregate Twelve Thousand Dollars (\$12,000.00) per annum, provided such disbursements have been made during the twelve (12) month period ending with the last day of the particular operating period and have not been previously deducted for the purpose of ascertaining available cash receipts, and provided further that any amounts in excess thereof may be so deducted if consented thereto in writing by the Beneficiary under said New First Deed of Trust or the Beneficiary under said New Second Deed of Trust or the holders or registered owners of not less than eighty per cent (80%) of the aggregate principal amount of the then outstanding "Huckins-Newcomb Hotel Company 5½% Bonds", dated May 1, 1932; (c) one-half of the Company's taxes payable for the current year, including ad valorem, income, profit, capital stock, license and all governmental charges, taxes and impositions to which the Company, its property or business may be subject; (d) all interest and principal and other payments and outlays required to be made by the terms of said New First Deed of Trust and said New First Chattel Mortgage; (e) all interest and principal and other payments and outlays required to be made by the terms

of said New Second Deed of Trust and said New Second Chattel Mortgage; (f) any and all other items, whether or not covered by the preceding clauses (a) to (e), the deduction of which in the ascertainment of available cash receipts is authorized and required by any order or regulations of any body, board, commission or governmental agency or others having jurisdiction, nor or at any time hereafter in effect, excluding, however, any deduction for or on account of depreciation of any property of the Company; and (g) provided, and in contemplation of the possibility and advisability of so doing, in event the Company shall upon previous approval of the Trustee under said Second Supplemental Indenture as hereinafter stated, hereafter contract for the erection and equipment of any addition to or alteration of its hotel structure situate upon the land described [32] in said New First Deed of Trust to specially accomodate any intending lessee, lessees or special group or class of patrons, and to be paid for with and from, solely, the rents, income, profits and proceeds of the use and occupancy of all or any part of such improvements, or contract, with like approval, for the installation of or change in equipment in or of such hotel to be paid for by, with and from the earnings and/or savings effected thereby, then the amount of income specially derived from or in connection with such addition, alteration and/or equipment and such earnings and/or savings effected by any such installation or change in equipment and required by such contract or contracts to be applied to and upon pay-

ment therefor, may also be deducted from gross cash receipts in the ascertainment of the amount of available cash receipts for interest as aforesaid; provided, further, however, that the effectiveness of the foregoing proviso is conditioned that the Company shall, before entering into any such contract, submit the same to and secure the approval thereof, in writing, by said Trustee; and (h) provided further that in the event that the Company's gross cash receipts during any operating period are not sufficient in amount to cover the items deductible therefrom, as herein provided, for the purpose of ascertaining available cash receipts for such operating period, the amount of such deficiency shall be carried over for the purpose of computing available cash receipts of successive operating periods until the full amount of such deficiency has been charged off against gross cash receipts thereafter received.

If action be instituted on this note, the Company promises to pay such sum as the Court may fix as attorney's fees. No action or proceeding shall be instituted on or in regard to this note except with the written consent of the holders of two-thirds ( $\frac{2}{3}$ ) or more in principal amount of the notes of this series then outstanding, and then only for the proportionate benefit of the holders of all of the notes of the series of which this note is one; and by acceptance of this note, the holder hereof assents to the foregoing and all of the other terms and provisions hereof.

In Witness Whereof, the Company has caused this note to be signed by its President or Vice President and its corporate seal to be hereunto affixed, and to be attested by its Secretary or an Assistant Secretary, as of the 1st day of July, 1938.

HILTON HOTEL COMPANY  
OF CALIFORNIA

By.....

Its.....President

Attest:

.....

Its.....Secretary

EXHIBIT 2

“Notice to Holder: This note may be registered as provided on the back hereof.”

Hilton Hotel Company of California

PREFERRED INCOME NOTE

No. 17

\$3,395.80

Know All Men by These Presents, That Hilton Hotel Company of California, a corporation duly organized and existing under and by virtue of the laws of the State of California, hereinafter referred to as the “Company”, acknowledges itself to owe and for value received promises to pay to J. W. Drown or order, the principal sum of Three Thousand Three Hundred Ninety-five and 80/100ths Dollars (\$3,395.80) on or before November 1, 1952, with interest on said principal sum from the date

hereof until maturity, at the rate of six per cent (6%) per annum, payable on November 1, 1938, and thereafter semiannually on the first days of May and November of each year until maturity; provided, however, that such interest shall be payable only out of the available cash receipts of the Company as hereinafter defined, for the operating period preceding each semiannual interest payment date, if and to the extent that such available cash receipts shall be sufficient for such payment.

If interest so paid shall be less than at the rate of six per cent (6%) per annum on this note, the difference between the amount equal to interest for any semiannual period immediately preceding any semiannual interest payment date at the rate of six per cent (6%) per annum and the amount of interest paid for such semiannual period, shall accumulate but without interest on such accumulated interest, until from and after November 1, 1952. In the event that available cash receipts for any operating period immediately preceding any semiannual interest payment date shall not be sufficient to pay interest at the rate of six per cent (6%) per annum for such period, such available cash receipts as are available for such period shall be distributed proportionately to the holders of notes of the series of which this note is one. In the event available cash receipts for any operating period are more than sufficient to pay current interest on said notes, together with all accumulated interest thereon, if any, the Company covenants to apply the excess of such available cash receipts, on the next interest payment

date, toward the payment of the principal of said notes. The principal of and accumulated interest on this note shall, after November 1, 1952, bear interest unconditionally at the rate of six per cent (6%) per annum until paid. Interest shall not be paid on accumulated interest until the maturity of this note and then only from and after such maturity.

All payments of principal and interest shall be paid in lawful money of the United States of America at the office of the Company, in the City and County of San Francisco, State of California, and shall be made proportionately to all holders of notes of this series.

This note is one of a series of notes of the Company known as "Hilton Hotel Company of California Preferred Income Notes", limited in the aggregate to the principal sum of Two Hundred Three Thousand Seven Hundred Forty-seven and 94/100ths Dollars (\$203,747.94).

The term "operating period" as used in this note is defined to mean each six (6) months period ending September 30 and March 31 of each year beginning with the six (6) months period ending September 30, 1938. The term "available cash receipts" as used in this note is hereby defined to mean the gross cash receipts of the Company from all sources received during each operating period less, for such operating period, (a) all of the Company's operating expenses, which term shall mean and embrace all costs, charges, outlays and payments made in [34] connection with or for materials, supplies, merchan-

dise, advertising, repairs, ordinary and current replacements, services, salaries, wages and (except as to undertakings secured by the New First Deed of Trust, the New First Chattel Mortgage, the New Second Deed of Trust, the New Second Chattel Mortgage and by that certain Second Supplemental Indenture, dated as of January 1, 1938, executed by the Company and Crocker First National Bank of San Francisco, and certain bondholders, and recorded on June 17, 1938 in Volume 3291 of Official Records at page 331, in the office of the Recorder of the City and County of San Francisco, State of California, said New First Deed of Trust, said New First Chattel Mortgage, said New Second Deed of Trust and said New Second Chattel Mortgage being described in said Second Supplemental Indenture) interest upon and principal of its obligations heretofore or hereafter contracted in good faith in pursuit of the Company's corporate purposes (except principal and interest on the notes of the series of which this is one), not including, however, any indebtedness to the Company's stockholders which existed on May 1, 1932, or any renewal of such indebtedness; (b) disbursements for necessary improvements and alterations to the property of the Company, ordinarily chargeable to capital, not exceeding in the aggregate Twelve Thousand Dollars (\$12,000.00) per annum, provided such disbursements have been made during the twelve (12) month period ending with the last day of the particular operating period and have not been previously deducted for the purpose of ascertaining available



cash receipts, and provided further that any amounts in excess thereof may be so deducted if consented thereto in writing by the Beneficiary under said New First Deed of Trust or the Beneficiary under said New Second Deed of Trust or the holders or registered owners of not less than eighty per cent (80%) of the aggregate principal amount of the then outstanding "Huckins-Newcomb Hotel Company 5½% Bonds", dated May 1, 1932; (c) one-half of the Company's taxes payable for the current year, including ad valorem, income, profit, capital stock, license and all governmental charges, taxes and impositions to which the Company, its property or business may be subject; (d) all interest and principal and other payments and outlays required to be made by the terms of said New First Deed of Trust and said New First Chattel Mortgage; (e) all interest and principal and other payments and outlays required to be made by the terms of said New Second Deed of Trust and said New Second Chattel Mortgage; (f) any, and all other items whether or not covered by the preceding clauses (a) to (e), the deduction of which in the ascertainment of available cash receipts is authorized and required by any order or regulations of any body, board, commission or governmental agency or others having jurisdiction, now or at any time hereafter in effect, excluding, however, any deduction for or on account of depreciation of any property of the Company; and (g) provided, and in contemplation of the possibility and advisability of so doing, in event the Company shall upon previous approval of the

Trustee under said Second Supplemental Indenture as hereinafter stated, hereafter contract for the erection and equipment of any addition to or alteration of its hotel structure situate upon the land described in said New First Deed of Trust to specially accommodate any intending lessee, lessees or special group or class of patrons, and to be paid for with and from, solely, the rents, income, profits and proceeds of the use and occupancy of all or any part of such improvements, or contract, with like approval, for the installation of or change in equipment in or of such hotel to be paid for by, with and from the earnings and/or savings effected thereby, then the amount of income specially derived from or in connection with such addition, alteration and/or equipment and such earnings and/or savings effected by any such installation or change in equipment and required by such contract or contracts to be applied to and upon payment therefor, may also be deducted from gross cash receipts in the ascertainment of the amount of available cash receipts for interest as aforesaid; provided, further, however, that the effectiveness of the foregoing proviso is conditioned that the Company shall, before entering into any such contract, submit the same to and secure the approval thereof, in writing, by said Trustee; and (h) provided further that in the event that the Company's gross cash receipts during any operating period are not sufficient in amount to cover the items deductible therefrom, as herein provided, for the purpose of ascertaining available cash receipts for such operating period, the amount of such deficiency

shall be carried over for the purpose of [35] computing available cash receipts of successive operating periods until the full amount of such deficiency has been charged off against gross cash receipts thereafter received.

If action be instituted on this note, the Company promises to pay such sum as the Court may fix as attorney's fees. No action or proceeding shall be instituted on or in regard to this note except with the written consent of the holders of two-thirds ( $2/3$ ) or more in principal amount of the notes of this series then outstanding, and then only for the proportionate benefit of the holders of all of the notes of the series of which this note is one; and by acceptance of this note, the holder hereof assents to the foregoing and all of the other terms and provisions hereof.

In Witness Whereof, the Company has caused this note to be signed by its President or Vice President and its corporate seal to be hereto affixed, and to be attested by its Secretary or an Assistant Secretary, as of the 1st day of July, 1938.

HILTON HOTEL COMPANY  
OF CALIFORNIA,

By C. N. HILTON,  
Its President.

Attest:

J. R. LING  
Its Assistant Secretary. [36]

## RECORD OF PAYMENTS

Date	Principal	Interest	Total
September 10, 1938	459.25	40.75	\$500.00
March, 1939	411.41	88.59	500.00
April 5, 1939	489.06	10.94	500.00
June 16, 1939	475.91	24.09	500.00
July 12, 1939	493.24	6.76	500.00
Sept. 4, 1940	427.28	72.72	500.00
April 7, 1941	333.34	19.30	352.64

March 17, 1939.

For value received I hereby assign my right and interest in this note to Louis R. Lurie—

M. DROWN

“This note may be registered in the holder’s name upon a register to be maintained by the Company at its office in San Francisco, California. Such registration shall be noted on this note by the Company, after which no transfer hereof shall be valid unless made on said register and noted on this note. The Company may deem and treat the person in whose name this note is from time to time registered as the absolute owner hereof for the purpose of receiving payments of principal and interest due hereon and for all other purposes.

(Registration)

Notice to Holder: Do not write on this note. Consult the Company for method of transferring registration.

Date of Registry August 6 1940

In Whose Name Registered Louis R. Lurie  
Register Hilton Hotel Company of California.

By J. R. LING

Authorized Officer.”

[Endorsed]: T.C.U.S. Filed Sept. 18, 1944. [37]

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In the United States Circuit Court of Appeals for  
the Ninth Circuit

No. 3571

BABETTE G. LURIE

Petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE  
Respondent.

DESIGNATION OF CONTENTS OF RECORD  
ON REVIEW

To the Clerk of the Tax Court of the United States:

Now comes Babette G. Lurie, the petitioner on review herein, by and through her attorneys, Oscar Samuels and Tevis Jacobs, and for the purpose of the review which she, the said petitioner, has heretofore taken to the United States Circuit Court of Appeals for the Ninth Circuit, hereby designates for inclusion in the record on review, the following:

1. Docket entries of the proceedings before The Tax Court of the United States.

2. Pleadings before The Tax Court of the United States as follows: (a) petition; and (b) answer.

3. Findings of fact and opinion promulgated by The Tax Court of the United States on March 31, 1945. [38]

4. Decision of The Tax Court of the United States entered on the 31st day of March, 1945.

5. Petition for review.

6. Notice of filing petition for review and acknowledgment of service of said notice.

7. Stipulation of facts.

8. This designation of contents of the record on review.

Dated: August 20 1945.

OSCAR SAMUELS

TEVIS JACOBS

Attorneys for petitioner

Service of the foregoing designation of contents of record on review is hereby admitted this 31 day of August 1945.

SAMUEL O. CLARK Jr.

Attorney for respondent.

[Endorsed]: T.C.U.S. Filed Sept. 19, 1945. [39]

The Tax Court of the United States  
Washington

Docket No. 3571

BABETTE G. LURIE

Petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE  
Respondent

CERTIFICATE

I, B. D. Gamble, clerk of The Tax Court of the United States do hereby certify that the foregoing pages, 1 to 39, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praeipie in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 26th day of Sept. 1945.

[Seal]

B. D. GAMBLE

Clerk, The Tax Court of the  
United States.

[Endorsed]: No. 11160. United States Circuit Court of Appeals for the Ninth Circuit. Babette G. Lurie, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of Record. Upon Petition to Review a Decision of The Tax Court of the United States.

Filed October 15, 1945.

PAUL P. O'BRIEN

Clerk of the United States Circuit Court of Appeals  
for the Ninth Circuit.

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In the United States Circuit Court of Appeals for  
the Ninth Circuit

Case No. 11160

BABETTE G. LURIE

Appellant

vs.

COMMISSIONER OF INTERNAL REVENUE  
Respondent

STATEMENT OF POINTS ON WHICH AP-  
PELLANT INTENDS TO RELY ON  
APPEAL AND DESIGNATION OF PARTS  
OF RECORD WHICH APPELLANT BE-  
LIEVES NECESSARY FOR CONSIDERA-  
TION THEREOF

I.

Points on which appellant intends to rely on  
appeal.



The appellant does hereby adopt the assignments of error set forth in the petition for review filed with the Clerk of The Tax Court of the United States on the 16th day of June, 1945, as the statement of points on which appellant intends to rely on appeal.

## II.

Designation of parts of record which appellant believes necessary for consideration thereof.

For consideration of the points on which appellant intends to rely on appeal the entire record as certified to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit by the Clerk of The Tax Court of the United States is designated as necessary and to be printed.

Dated October 19, 1945.

OSCAR SAMUELS

TEVIS JACOBS

Attorneys for Appellant

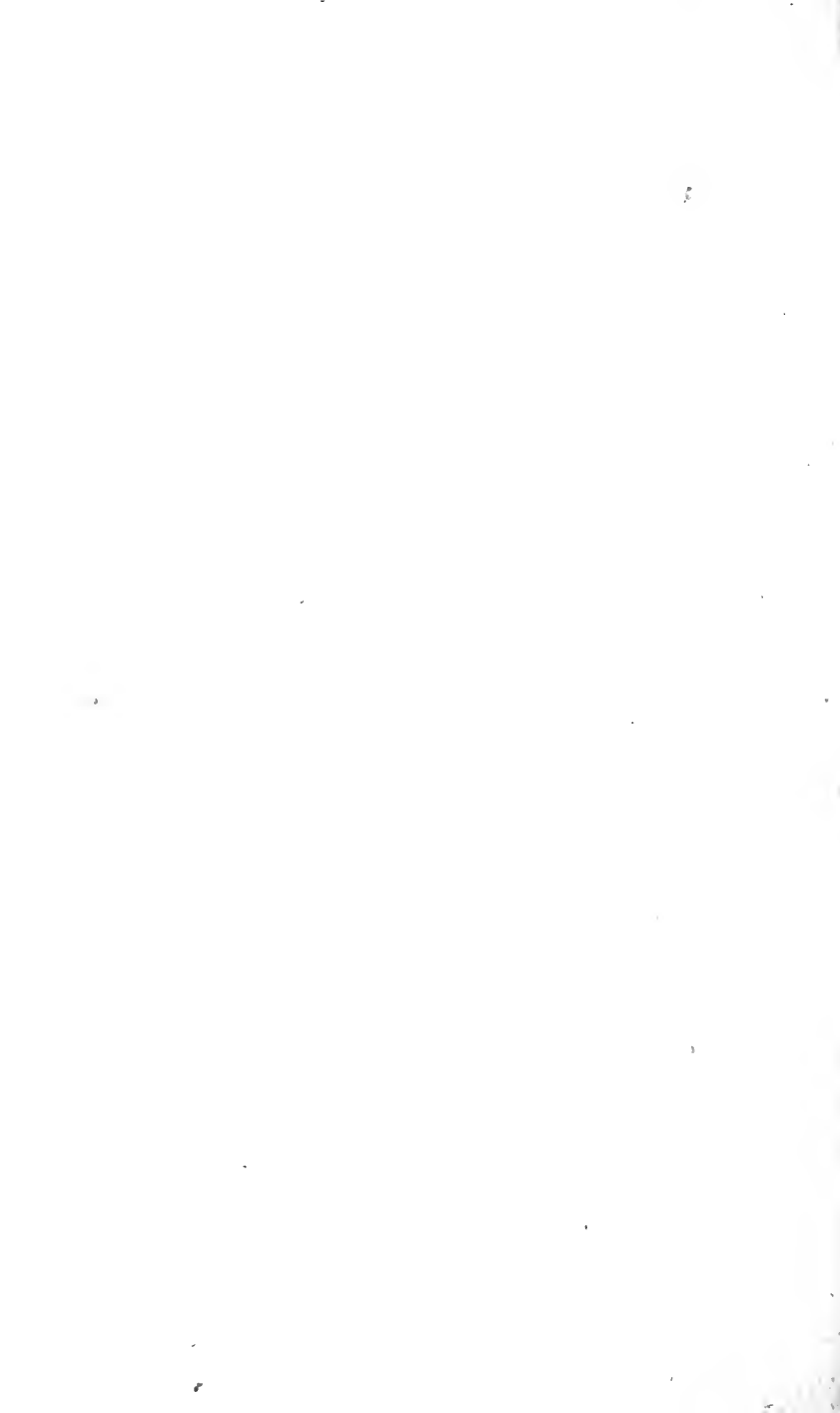
Service of the foregoing is hereby admitted this 22nd day of October, 1945.

SAMUEL O. CLARK, Jr.,

Assistant Attorney General,

Attorney for Respondent.

[Endorsed]: Filed October 29, 1945. Paul P. O'Brien, Clerk.



No. 11,160

IN THE  
United States Circuit Court of Appeals  
For the Ninth Circuit

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BABETTE G. LURIE,

*Petitioner,*

VS.

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

PETITIONER'S OPENING BRIEF.

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OSCAR SAMUELS,

TEVIS JACOBS,

333 Montgomery Street, San Francisco 4, California,

*Attorneys for Petitioner.*

FILED

DEC 26 1945

PAUL P. O'BRIEN  
CLERK



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IN THE  
**United States Circuit Court of Appeals**  
**For the Ninth Circuit**

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BABETTE G. LURIE,

*Petitioner,*

VS.

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

---

**PETITIONER'S OPENING BRIEF.**

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**STATEMENT OF THE PLEADINGS.**

Petitioner is a resident of San Francisco, California, and filed her income tax return for the year ending December 31, 1941, with the Collector of Internal Revenue for the First District of California at San Francisco. On the 22nd day of October, 1943, respondent issued a 90-day letter determining a deficiency of income taxes for said year in the amount of \$1177.03. On the 6th day of December, 1943, petitioner filed a petition for redetermination of said deficiency with The Tax Court of The United States, which Court rendered its decision on the 31st day of March, 1945, determining the deficiency in said amount of \$1177.03. On the 16th day of June, 1945, petitioner filed her petition for review by the United States Circuit Court of Appeals for the Ninth Circuit of said

decision of said Tax Court. The jurisdiction of this Court to review the aforesaid decision of The United States Tax Court is founded on Internal Revenue Code Section 1141(a) (b) (1).

Petitioner claimed in her said income tax return for the year 1941 that the profit realized upon retirement of certain preferred income notes resulted in a long term capital gain. Respondent assessed an income tax deficiency for said year contending that the profit realized upon the retirement of said notes constituted ordinary income.

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#### **QUESTION PRESENTED.**

When preferred income notes not in registered form, of a series issued by a corporation, are purchased by an individual taxpayer at less than face value and all of the outstanding notes are thereafter returned to the corporation to permit of a form of registration being printed on each and the registration thereof, is the profit on retirement of said notes a long term capital gain under the law as it existed in 1941 when the retirement occurred more than two years after acquisition of said notes by the taxpayer although less than 18 months after the form of registration was printed on each of said notes and each of them was registered?



### **SPECIFICATION OF ERROR.**

1. The Tax Court erred in determining that Section 117(f) of the Internal Revenue Code has no application to notes converted into registered form less than 18 months before retirement with the result that the profit realized upon retirement was held to constitute ordinary income rather than a long term capital gain.

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### **SUMMARY OF THE FACTS.**

Petitioner purchased some preferred income notes of a series issued by Hilton Hotel Company of California, a corporation, at a discount. Subsequently the corporation requested that all of said series of said notes be returned to it so that they could be converted into registered form by printing on each a form of registration. All notes issued were so returned to the corporation and transmuted into notes in registered form and all were registered. During the following year but less than 18 months after such registration, the notes were retired at face value, resulting in a profit to petitioner.

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### **STATEMENT OF THE FACTS.**

All the facts in the case were presented to The Tax Court by stipulation. (T. p. 26.)

1. A series of preferred income notes was issued by Hilton Hotel Company of California, a corporation,

during the year 1938 in the total amount of \$203,747.94. (T. pp. 26, 27.)

2. Said notes were issued pursuant to the permit of the Commissioner of Corporations. (T. pp. 26, 27.)

3. In 1938 and early in 1939 petitioner acquired units each of which included a certain percentage of all of the outstanding securities and obligations of said corporation. Included in each unit were preferred income notes acquired at less than face value, which notes are the subject of the instant matter. (T. p. 27.)

4. In the application to the Corporation Commissioner for the permit to issue said preferred income notes it was recited:

“Said new promissory notes are to be registered and applicant hereby designates itself to act as the registrar thereof.” (T. p. 28.)

5. Annexed to said application was a printed form of a preferred income note, a copy of which, designated Exhibit 1, is set forth in the transcript (T. p. 31) and an additional printed page entitled “Registration,” on which was set forth a form for registering said notes. (T. p. 28.) When said notes were finally printed and issued said additional page on which said form for registration was printed, was omitted and they were in the form of said Exhibit 1. (T. p. 28.)

6. In August of 1940 the company requested of the holders of said notes that they be returned to it. (T. p. 28.) The notes were thereupon returned to the company and on the face of each of said notes was printed the following:

“Notice to Holder: This note may be registered as provided on the back hereof.”

and on the back of each was printed the following:

“This note may be registered in the holder’s name upon a register to be maintained by the Company at its office in San Francisco, California. Such registration shall be noted on this note by the Company, after which no transfer hereof shall be valid unless made on said register and noted on this note. The Company may deem and treat the person in whose name this note is from time to time registered as the absolute owner hereof for the purpose of receiving payments of principal and interest due hereon and for all other purposes.

(Registration)

Notice to Holder: Do not write on this note. Consult the Company for method of transferring registration.

Date of Registry.

-----  
In Whose Name Registered.

-----  
Register Hilton Hotel Company of California

By.....

Authorized Officer.”

(T. pp. 28, 29.)

7. On August 6, 1940, the taxpayers returned to said corporation the notes involved in this action and had them registered in the name of Louis R. Lurie, husband of petitioner. (T. p. 29.)

8. All of the notes in question were retired in 1941, more than two years after the acquisition of them by the petitioner and less than 18 months after their registration as aforesaid, at a profit in the instance of petitioner in the amount of \$3448.43. This profit was returned by petitioner as a capital gain. Respondent contends that said profit is ordinary income. (T. p. 30.)

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#### **SUMMARY OF THE ARGUMENT.**

The preferred income notes were indisputably capital assets. Admittedly they were held for more than 18 months and so upon a sale or exchange of each of them the holder would be entitled to a long term capital gain. Section 117(f) of the Internal Revenue Code provides that the retirement of notes in registered form constitutes a sale or exchange and no mention is made in said section of the time of holding said notes; therefore the retirement of the notes in question constituted a sale or exchange and said notes being capital assets held more than 18 months, the difference between the purchase price and the amount received upon retirement constituted a long term capital gain.

## ARGUMENT.

### I.

#### THE NOTES ARE CAPITAL ASSETS HELD FOR MORE THAN TWO YEARS.

The term "capital assets" includes all classes of property not specifically excluded by Internal Revenue Code Section 117(a)(1),<sup>1</sup> regardless of the period for which such capital assets are held.<sup>2</sup> As stated in the opinion of The Tax Court "There is, and can be, no question raised as to the fact that the notes in question were capital assets under the statutory definition of Section 117(a)(1)." (T. p. 17.)

It is stipulated that the notes were acquired more than two years before retirement. (T. p. 27.)

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<sup>1</sup>Internal Revenue Code, Section 117(a)(1):

"(a) Definitions.—As used in this title—

(1) Capital Assets.—The term 'capital assets' means property held by the taxpayer (whether or not connected with the trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (1)."

<sup>2</sup>Regulations 103, Section 19.117-1:

"Meaning of terms.—The term 'capital assets' includes all classes of property not specifically excluded by (Code) section 117(a)(1). In determining whether property is a 'capital asset', the period for which held is immaterial."

## II.

**THE RETIREMENT OF THE NOTES, SINCE THEY WERE IN REGISTERED FORM, CONSTITUTED A SALE OR EXCHANGE.**

Since the notes in question were capital assets and were admittedly held for more than two years, the sole issue is whether or not the retirement of said notes constituted a sale or exchange. If the retirement did constitute a sale or exchange the profit thereon would necessarily be a capital gain and since they were held for more than two years it would be a long term capital gain<sup>3</sup> as reported by the petitioner in her income tax return. Section 117(f) of the Internal Revenue Code as originally adopted in 1934 and

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<sup>3</sup>Internal Revenue Code, Section 117(a)(2) and Section 117(a)(4):

“(a) Definitions.—As used in this title—

\* \* \* \* \*

(2) Short-term capital gain.—The term ‘short term capital gain’ means gain from the sale or exchange of a capital asset held for not more than 18 months, if and to the extent such gain is taken into account in computing net income.

\* \* \* \* \*

(4) Long-term capital gain.—The term ‘long term capital gain’ means gain from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such gain is taken into account in computing net income.”

Internal Revenue Code, Section 117(b):

“(b) Percentage Taken Into Account.—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 18 months;

66 $\frac{2}{3}$  per centum if the capital asset has been held for more than 18 months but not for more than 24 months;

50 per centum if the capital asset has been held for more than 24 months. \* \* \*”

which has persisted in subsequent acts, and in the Internal Revenue Code, provides that the retirement of certain types of securities, including notes in registered form, constitutes a sale or exchange.<sup>4</sup> The principles of the capital gains and losses provision of the law must be clearly borne in mind: (a) The asset must be a capital asset; (b) the asset must be sold or exchanged; and (c) if the asset is held for a certain period of time the sale or exchange results in a long term capital gain or loss; if not so held, the sale or exchange results in a short term capital gain or loss.

In the instant case the provisions of (a) and (c) have been complied with so as to entitle the petitioner to claim a long term capital gain or loss; that is, the notes were capital assets and they were held for more than two years. The issue is narrowed down to only one limited question: Was there a sale or exchange of said notes?

Before answering that question petitioner must ask the indulgence of the Court for what may appear to have been an over-simplification of the capital gains and losses provision of the law but it is here that The Tax Court confused the issue. The last paragraph of The Tax Court's Opinion reads as follows:

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<sup>4</sup>Internal Revenue Code, Section 117(f):

“(f) Retirement of Bonds, Etc.—For the purposes of this title, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.”

“In our opinion there can be no doubt that, taking all the provisions of section 117 into consideration and having due regard for the purposes of the section, to come within section 117(f) the notes must be, at the very least, in registered form for the minimum period provided by section 117(b). This period is 18 months. Since petitioners' notes were in registered form for less than such period before retirement, they do not qualify under section 117(f).” (T. p. 21.)

It would seem clear that the holding period has no relation whatsoever to the question of whether or not the retirement constitutes a sale or exchange. If the notes were held for less than 18 months the retirement would have been a sale or exchange but the gain would have been a short term one; if over 18 months a long term one. To say that the notes do not qualify under Section 117(f) is a misconception of the law, for Section 117(f) has no reference to the holding period of a capital asset. To hold otherwise would mean that the retirement of corporate coupon bonds in less than 18 months would not be a short term capital gain or loss but would result in ordinary income or loss.

We can only question whether or not The Tax Court would have reached the same conclusion and would have allowed an ordinary loss rather than a short term capital loss, were it presented with a situation involving a loss from retirement a few months after purchase of a corporate coupon bond.



If the petitioner had sold the notes after she had held them for two years but prior to retirement, and even in anticipation thereof, the transaction would necessarily have been a long term capital gain.

*McKee v. Commissioner*, 35 B.T.A. 239 (acq.);  
*Hobby v. Commissioner*, 2 T.C. 980 (acq.).

Under Section 117(f) retirement is the equivalent of a sale or exchange.

The history of the effect of retirement of bonds and registered notes is set forth in The Tax Court's Opinion in which reference is made first to the case of *Werner v. Commissioner*, 15 B.T.A. 482, which held that retirement of bonds constituted a sale or exchange. Some years later this case was overruled in *Watson v. Commissioner*, 27 B.T.A. 463. From that time on until the enactment of Section 117(f) in 1934 it was settled that the retirement of bonds did not constitute a sale or exchange. (*Fairbanks v. United States*, 306 U. S. 436, 59 S.C. 66, 83 L. Ed. 855; *Commissioner v. Caulkins*, 6th Cir., 144 F. (2d) 482.)

It would appear that the obvious purpose of the section was that profit or loss received upon retirement of a security should be a capital transaction while profit or loss on the payment of an ordinary obligation should be ordinary income or loss. In the instant case, a series of preferred income notes was issued pursuant to a permit of the Commissioner of Corporations of the State of California. These notes were in printed form. Although the application to the Corporation Commissioner evidences the intention of

the corporation that the notes were to be issued in registered form, for some undisclosed reason this was neglected. Nevertheless the purchase of said notes, particularly when acquired as a portion of a unit containing other securities, would ordinarily be deemed by any investor to be the acquisition of securities. Had they at no time been in registered form the retirement necessarily could not have been considered a sale or exchange but that would have been due to the force of Section 117(f). Further restricting the meaning of Section 117(f) would result in placing an unwarranted limitation upon normal business transactions without reason therefor. It is submitted that such was not the intention of Congress but that the sole restriction that notes must be in registered form was inserted primarily to differentiate between a note susceptible to registration and the ordinary promissory note, so that payment of an ordinary obligation in the normal course of business would not result in a capital gain or loss.

It should be noted that the question of determining the effect of a sale or exchange of an asset is controlled by the conditions in existence at the date of the sale or exchange. The Commissioner of Internal Revenue has always recognized that the holding period for residential property subsequently converted into business property commenced not at the time of conversion but at the time of the original acquisition of the property. (See I.T. 3041, 1927-1, C.B. 148, followed in *Kimbell v. Commissioner*, 41 B.T.A. 940.)

When a capital asset has been exchanged in a non-taxable exchange the holding period commences from the time of acquisition of the original asset under Internal Revenue Code Section 117(h)(1).<sup>5</sup> In the instant case, even though the return of the notes to the corporation for change to registered form and registration be deemed to be an exchange (and no contention is made by the Commissioner that it was or could be a taxable exchange) then the holding period still reverts to the original date.

In the recent case of *Gracey v. Commissioner*, 5 T.C. 296, The Tax Court held that even though an asset which was not a capital asset was converted by a non-taxable exchange into a capital asset a few months prior to sale, the sale of such asset resulted in a long term capital gain.

As stated in the case of *Commissioner v. Caulkins*, supra, "Where statutory standards are lacking, statutory language is to be read in its natural and common meaning." It has been shown that under the natural and common meaning of Section 117(f) the retirement of the registered notes in question constituted a capital gain. However, The Tax Court endeav-

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<sup>5</sup>Internal Revenue Code, Section 117(h)(1):

"(h) Determination of Period for Which Held.—For the purpose of this section—

1. In determining the period for which the taxpayer has held property received on an exchange there shall be included the period for which he held the property exchanged, if under the provisions of section 113, the property received has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as the property exchanged."

ored to read into the law that which does not appear therein and gives as an excuse therefor that the literal language of the Code would allow taxpayers to determine for themselves whether to take a capital gain or loss merely by last-minute registration by the holder of a particular note. (T. p. 20.) (It must be noted that there is no finding or evidence that any effort to avoid taxes was involved in the present case.) The Tax Court again misconceives the clear language of Section 117(f). Whether a particular holder of a note registers it or not has no tax consequence. The only issue is whether or not the notes were in registered form. Even so, as above explained, the holder could always sell the note before retirement and thus procure a capital gain; thus in the instant case if the petitioner, instead of relying upon the clear unequivocal language of Section 117(f) had sold the notes before retirement the respondent would not have questioned the fact that a capital gain resulted. There is no justification for The Tax Court endeavoring to change the clear language of Section 117(f) so as to include therein an additional requirement relating to the holding period of the asset.

**CONCLUSION.**

It is respectfully submitted:

1. That the preferred income notes in question were capital assets; (Internal Revenue Code, Section 117 (a)(1).)

2. That said assets were held by the petitioner for more than two years; (Internal Revenue Code, Section 117(a)(4).)

3. That the retirement thereof constituted a sale or exchange. (Internal Revenue Code, Section 117(f).)

Therefore petitioner properly reported her income from the transaction and the decision of The Tax Court should be reversed.

Dated, San Francisco, California,

December 24, 1945.

Respectfully submitted,

OSCAR SAMUELS,

TEVIS JACOBS,

*Attorneys for Petitioner.*



No. 11160

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**In the United States Circuit Court of Appeals  
for the Ninth Circuit**

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**BABETTE G. LURIE, PETITIONER**

*v.*

**COMMISSIONER OF INTERNAL REVENUE, RESPONDENT**

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**ON PETITION FOR REVIEW OF THE DECISION OF THE TAX  
COURT OF THE UNITED STATES**

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**BRIEF FOR THE RESPONDENT**

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**SEWALL KEY,**

*Acting Assistant Attorney General.*

**ROBERT N. ANDERSON,**

**LOUISE FOSTER,**

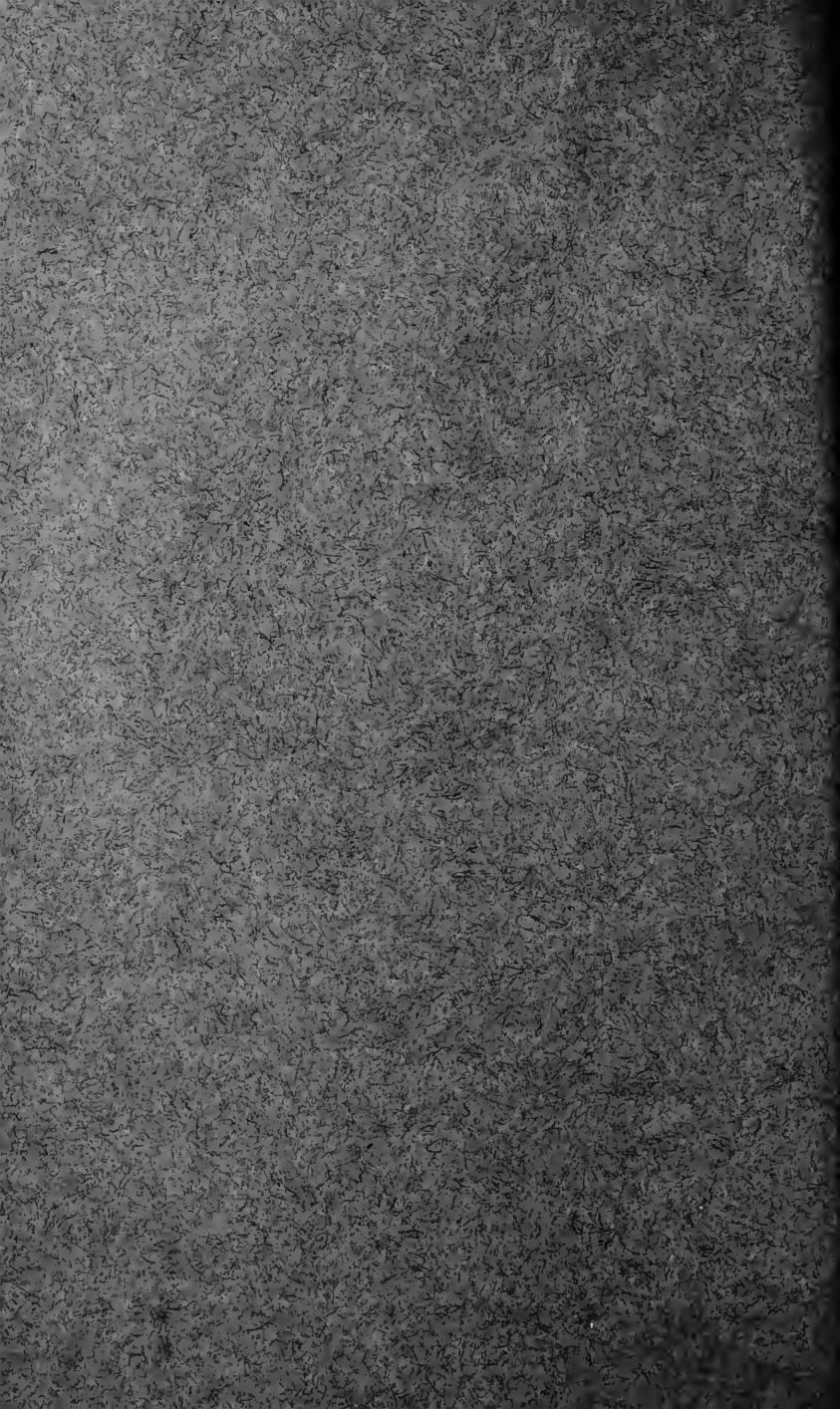
*Special Assistants to the Attorney General.*

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**FILED**

**JAN 30 1946**

**PAUL P. O'BRIEN,**  
**CLERK**





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# **In the United States Circuit Court of Appeals for the Ninth Circuit**

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No. 11160

BABETTE G. LURIE, PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

---

*ON PETITION FOR REVIEW OF THE DECISION OF THE TAX  
COURT OF THE UNITED STATES*

---

**BRIEF FOR THE RESPONDENT**

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## **OPINION BELOW**

The findings of fact and opinion of the Tax Court (R. 13-21) are reported at 4 T. C. 1065.

## **JURISDICTION**

This petition for review involves income tax for 1941 in the amount of \$1,177.03. (R. 22-25.) On October 22, 1943, the Commissioner of Internal Revenue mailed a notice of deficiency to the taxpayer. (R. 7-11.) Within 90 days thereafter, i. e., on December 6, 1943, the taxpayer filed its petition with the Tax Court for a redetermination of the deficiency under Section 272 of the Internal Revenue Code. (R. 1, 3-6.) The tax Court entered its decision on March 31, 1945, finding the deficiency in the amount stated

above. (R. 22.) The petition for review by this Court was filed June 16, 1945 (R. 22-25), pursuant to the provisions of Sections 1141-1142 of the Internal Revenue Code.

#### QUESTION PRESENTED

Whether, in computing her net income, the taxpayer should include, as ordinary income, the entire amount of gain realized by her upon retirement of certain preferred income notes which she had held for about two years but which were returned to the issuing company for registration less than 18 months before retirement; or whether such gain constituted long-term capital gain under Section 117 of the Internal Revenue Code, and is taxable only to the extent provided therein.

#### STATUTE INVOLVED

Internal Revenue Code:

#### SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from \* \* \* professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever, \* \* \*

\* \* \* \* \*

(26 U. S. C. 1940 ed., Sec. 22.)

# SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital assets.*—The term “capital assets” means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (1);

(2) *Short-term capital gain.*—The term “short-term capital gain” means gain from the sale or exchange of a capital asset held for not more than 18 months, if and to the extent such gain is taken into account in computing net income;

\* \* \* \* \*

(4) *Long-term capital gain.*—The term “long-term capital gain” means gain from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such gain is taken into account in computing net income;

\* \* \* \* \*

(b) *Percentage taken into account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a

capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for not more than 18 months;

66 $\frac{2}{3}$  per centum if the capital asset has been held for more than 18 months but not for more than 24 months;

50 per centum if the capital asset has been held for more than 24 months.

\* \* \* \* \*

(f) *Retirement of bonds, etc.*—For the purposes of this chapter, amounts received by the holder upon the retirement of bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any corporation (including those issued by a government or political subdivision thereof), with interest coupons or in registered form, shall be considered as amounts received in exchange therefor.

\* \* \* \* \*

(26 U. S. C. 1940 ed., Sec. 117.)

#### STATEMENT

The facts as found by the Tax Court are as follows:

The taxpayer and her husband reside in San Francisco, California. They filed their income tax returns for the year 1941 with the Collector of Internal Revenue for the First District of California. (R. 14.)

In 1938 the Hilton Hotel Company of California (then known as Huckins-Newcomb Hotel Company), hereinafter called the company, had outstanding various stock, bonds, notes and other obligations. A group of individuals, including the taxpayer, acquired all of such securities and obligations. In order to

facilitate the handling of them, units were formed, consisting of an equal percentage of all of the securities and obligations. Thereupon, pursuant to permits of the Commissioner of Corporations of California, each member of the group received voting trust certificates, promissory notes and other securities in proportion to the number of units held by him. Included was a series of preferred income notes in the total amount of \$203,747.94, issued pursuant to a permit of the Commissioner of Corporations. Each note was a printed document containing no reference to registration. (R. 14.)

At the time of the original issuance of the notes, the taxpayer and her husband jointly owned approximately one-third of the units and therefore owned one-third of the outstanding securities, including one-third of the total amount of the preferred income notes. Shortly thereafter, late in the year 1938 and early in 1939, they acquired additional units and included in each were preferred income notes which were acquired at less than face value and which are involved herein. After the acquisition of these additional units, they owned slightly in excess of 40 percent of the units. (R. 15.)

The voting trustees in the voting trust certificates included in the units consisted of the taxpayer's husband, Louis R. Lurie, C. N. Hilton and Don B. Burger, the last named being an owner of a small number of voting trust certificates and prior preferred income notes and an employee of C. N. Hilton. The remaining voting trust certificates and prior preferred income notes (and other securities of the corporation

in the same proportion) were owned by C. N. Hilton and various associates of his who at all times controlled the company and whose attorney was employed as attorney for the company. The directors of the company consisted of Louis R. Lurie, his auditor J. A. Kurzman, C. N. Hilton, Don B. Burger and Packey Dee of Chicago. (R. 15.)

In the application for the permit to issue the promissory notes, it is recited: "Said new promissory notes are to be registered and applicant hereby designates itself to act as the registrar thereof". Annexed to the application was a printed form of a preferred income note and there was an additional printed page entitled "Registration", on which was set forth a form for registering the notes. When the notes were finally printed and issued, the page entitled "Registration" was omitted. In August of 1940, the company requested the holders of the notes to return them to it. (R. 15-16.)

The notes were thereupon returned to the company and on the face of each of the notes was printed the following (R. 16, 28): "Notice to Holder: This note may be registered as provided on the back hereof", and on the back of each was printed the following (R. 16):

This note may be registered in the holder's name upon a register to be maintained by the Company at its office in San Francisco, California. Such registration shall be noted on this note by the Company, after which no transfer hereof shall be valid unless made on said register and noted on this note. The Company may deem and treat the person in whose



name this note is from time to time registered as the absolute owner hereof for the purpose of receiving payments of principal and interest due hereon and for all other purposes.

(Registration)

Notice to Holder: Do not write on this note. Consult the Company for method of transferring registration.

Date of Registry: In Whose Name Registered: Register Hilton Hotel Company of California.

By-----  
Authorized Officer.

On August 6, 1940, the taxpayer and her husband returned the notes involved herein and had them registered in the husband's name. A photostatic copy of one of the original notes, after registration, is in the record and reference is here made to it. For the year 1940 they returned the profit on the principal payments made on account of the notes in that year after registration as a capital gain and the Bureau of Internal Revenue held it to be ordinary income. The taxpayer acceded to the contention of the Bureau on advice of counsel that, regardless of whether or not the notes were in registered form, the notes were not retired in the year 1940 as required by Section 117 (f) of the Revenue Act in order to fall within its terms. (R. 17.)

All of the notes in question were retired in 1941, more than two years after the acquisition of them by the taxpayer and her husband and less than 18 months after the date that the notes were returned to the company and registered as stated above, at a profit

to each of them in the amount of \$3,448.53. This profit was returned by each as a capital gain. The Commissioner determined that such profit was ordinary income. (R. 17.)

The Tax Court held that the taxpayer was not entitled to treat her profit as a capital gain. Accordingly it found a deficiency in income tax for 1941 in the amount of \$1,177.03. (R. 21-22.)

#### SUMMARY OF ARGUMENT

The Tax Court correctly held that the gain realized from the retirement of the notes involved here is subject to tax in its entirety. As the privilege which taxpayer seeks relates to an exemption from tax on a portion of the gain admittedly received, the statute must of course be strictly construed against her, and the privilege can be granted only upon clear statutory authority. The statutory provisions on which the taxpayer relies to show that 50 percent of such gain may be excluded from gross income require that the notes be issued by the corporation in registered form but it is admitted that the notes here were not so issued and were not put into registered form until a year before their retirement. In contending that such registration was sufficient, taxpayer argues that it is not necessary that they be in registered form throughout the required holding period, but this view is erroneous because it ignores the plain meaning of certain language in the statute. It also permits various provisions of the statute to be construed and applied separately and without regard to other provisions. However, whenever the section covering capital gains and losses is read as a whole, it will be

seen that Congress has granted the privilege of excluding a portion of the gain realized from the retirement of notes only when such notes have been held throughout the required period in registered form.

#### ARGUMENT

The Tax Court correctly held that the gain realized upon the retirement of the notes involved here was not a long-term capital gain within the meaning of Section 117 of the Internal Revenue Code and so was taxable in its entirety

In taking this appeal from the Tax Court's decision, the taxpayer is seeking to have this Court hold that 50 percent of the gain, which she admittedly realized upon the retirement of the corporate notes involved here, should be excluded from taxable income. Obviously, in order to maintain her position, the taxpayer must do more than show that the applicable revenue statute does not specifically prohibit the exclusion of such portion of this income. She must point to a provision in the statute specifically authorizing the exclusion but we submit that she has not and cannot do this.

The taxpayer relies on Section 117 of the Internal Revenue Code, *supra*, which refers to capital assets. Her argument, in substance, is that, since the notes here are capital assets within the meaning of that section and were acquired more than 24 months before their retirement, the income realized therefrom was "long-term capital gain" as defined in paragraph (a) (4), and so only the percentage designated in paragraph (b) of that section need be taken into account when computing her net income.

The taxpayer of course recognizes that she must meet the requirements of Section 117 (f), *supra*, which refers specifically to the retirement of bonds and notes, but contends that she has met these requirements and appears to deny that subsection (f) must be read or considered with the other provisions of Section 117. At least counsel for taxpayer asserts (Br. 10) that the provisions covering the holding periods for capital assets have no relation whatsoever to Section 117 (f) and states (Br. 8) that the sole issue here is whether or not the retirement of the notes constituted a sale or an exchange. We cannot agree.

It is of course well established that the retirement of bonds or notes is actually not a sale or an exchange when those terms are given their usual and ordinary meaning. *Fairbanks v. United States*, 306 U. S. 436. Furthermore, prior to the passage of the Revenue Act of 1934, gain realized upon the retirement of bonds or notes was treated as ordinary income, but by the insertion of subsection (f) in Section 117 of that Act. Congress brought the retirement of certain securities for the first time within the category of capital gains and losses. *McClain v. Commissioner*, 311 U. S. 527. Specifically, Section 117 (f) provides that the amounts received by the holder upon the retirement of such securities "shall be considered as amounts received in exchange therefor." But the significant and, for our purpose, decisive portion of Section 117 (f) is that describing the securities which may be so treated. These include—

bonds, debentures, notes, or certificates or other evidences of indebtedness issued by any cor-

*poration* \* \* \* with interest coupons or *in registered form*, \* \* \*. [Italics supplied.]

Language in a statute is to be given, of course, its ordinary and usual meaning. Thus the word "issued", when given its generally accepted connotation, means sent forth or given out, but when that definition is applied here it must be admitted that these notes were not *issued* in registered form.<sup>1</sup> The notes were actually issued by the corporation in 1938 and in 1939 but registration did not occur until after August of 1940. (R. 15, 16.) In that month the corporation requested that all notes be returned for registration and certain statements relative to registration were printed on them. Then, for the first time, could it be said that they were in registered form as required by Section 117 (f). Consequently, it is our first contention that the taxpayer fails here because she cannot show that the notes were in registered form at the time of their issuance.

The Tax Court found it unnecessary to pass on this contention (R. 21) and counsel for the taxpayer, while admitting that the notes had to be in registered form before retirement, argue that our view of the statute places an unwarranted limitation upon normal business transactions (Br. 12). In other words, while counsel admit that the taxpayer realized gain from the retirement of her notes and that such gain would be entirely subject to tax without the provisions in subsection (f), they now argue, in effect, that she

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<sup>1</sup> As it is not claimed that there were any interest coupons attached, the taxpayer is required to show that the notes here were in registered form.

should be accorded the privilege of excluding 50 per cent of such gain from tax without showing that she comes strictly within its provisions.

It is of course well established that all provisions granting exemptions from tax will be strictly construed and in favor of the Government to the end that the revenues will be protected. Moreover, the statute must be construed and applied as written. Congress used the term "issued" and surely did not mean for it to be treated as a superfluous word as counsel for the taxpayer implies. We submit that, as the notes here were not *issued* in registered form the taxpayer does not come within the language of Section 117 (f).

However, if we are wrong in our first contention, and if it is sufficient that the notes be registered before retirement, we submit it is still evident that the taxpayer should not prevail here for, as the Tax Court held (R. 21), the notes must be placed in registered form more than 18 months before retirement in order for the gain which is realized therefrom to be treated as long-term capital gain within the meaning of Section 117 (a) (4).

In disagreeing with the Tax Court's interpretation of Section 117, counsel for the taxpayer contend that subsection (f) has no relation to, and need not be considered with, the provision prescribing the holding period for capital assets. Thus, under the taxpayer's view, a note which had been held for two years could be returned, as here, and put into registered form, even if such action was taken only one day before retirement; and still the gain therefrom should be treated as a long-term capital gain, taxable only to

the extent indicated in subsection (b). But as the Tax Court so aptly pointed out (R. 20)—

Such a last-minute registration just before retirement, even after the call for retirement has been issued, would permit the holders of notes or other securities to determine for themselves, in accord with their individual advantage, the tax consequences that would flow from retirement without regard for uniformity of treatment or the interests of the Government. The suggested interpretation seems contrary to the whose basic concept of section 117 (f).

The Tax Court is undoubtedly right. If notes need not be held in registered form for more than 18 months in order to treat the gain from retirement as long-term capital gain, then taxpayers can choose their time for registration. Thus they could postpone registration until it was known whether the contemplated retirement would result in a gain or a loss, and if the latter was expected they could decide not to register the notes at all. In such case they would not come under Section 117 at all and could deduct the whole loss. On the other hand, if they saw a gain would be realized, they could register their notes shortly before retirement and enjoy the privileges of Section 117. Certainly the situation can be so controlled if the taxpayers are stockholders of a closely owned corporation, as is the husband of taxpayer here. But we submit that it was not the intention of Congress to leave the matter open in this way and that it has not done so.

In contending otherwise, counsel for taxpayer consider it sufficient to show that the notes here were

capital assets, that they were held for two years or more, and that they were retired by the issuing corporation. We do not of course deny such facts but we maintain that, since the taxpayer would be taxable on the entire amount of realized gain without subsection (f), she can secure the privilege she now seeks only by showing that throughout the required holding period, her notes were actually the kind of notes referred to in subsection (f), namely, notes in registered form. If for one year of that time, the notes were not the kind to which this special privilege attaches, then how can the taxpayer claim that she was within the requirements of Section 117? We think it is evident that she should not be allowed to do so and if the limitation seems a hard one, that is a matter for Congress to remedy.

Counsel for taxpayer refer (Br. 11) to notes which are sold but its illustration is not helpful here. Any note is a capital asset and if sold at a profit after two years, the gain therefrom is clearly taxable to the limited extent permitted by Section 117 but obviously, since that transaction does not involve a retirement, subsection (f) has no application and registration need not be considered at all in the example cited.

Counsel also refer to other cases to illustrate their contention that it is the status of an asset at the date of sale or exchange which is controlling. (Br. 12-14.) The answer to such contention is also that we do not have either a sale or exchange here, but a retirement which is accorded a special treatment. Furthermore, by the special permission of Congress, granted in Section 117 (f), gain from retirement may be only treated



as an amount received on an exchange if the security involved is one of those described therein, and the significant date is the issuance of the security for it is then that its nature can be determined. Or if, as here, a note is issued without registration but is recalled and changed into registered form, then reissued, its determining character may date from the reissuance, as the Tax Court held.

Consequently, the situation in the instant case is different from that in cases like *Kimbell v. Commissioner*, 41 B. T. A. 940, relied on by the taxpayer. That case involved a house which was first used as a residence and later for business. In determining how much of the gain or loss was includible in net income under Section 117 (b), it was held there that the whole period for which it was held could be considered. Of course a house is a capital asset regardless of what kind of property it is and there are no limiting provisions in Section 117 which might prevent the gain or loss from the sale thereof from being treated as a long-term capital gain or loss. Thus all that had to be determined there was the period for which it was held. But in the case of notes there are qualifying provisions in subsection (f) and if such notes meet those requirements for only a portion of the required holding period in subsection (b), with which it must necessarily be read, then it cannot be said that the taxpayer was holding the kind of note required by subsection (f) for the full period.

Indeed, when the notes are unregistered for a portion of the period, as was true here, the situation is

similar to that in which two closely related kinds of property are held. In the latter case, a taxpayer is not permitted to add the periods for which he has held the two kinds of property in order to show that he has met the statutory requirement for holding. Thus, in the case of *In re Rogers' Estate*, 143 F. 2d 695 (C. C. A. 2d), certiorari denied, 323 U. S. 780, the period for which shares of stock were held could not be added to the period of holding the notes given in payment therefor in determining how much of the gain was includible in net income under Section 117. Also cf. *Helvering v. San Joaquin Co.*, 297 U. S. 496, in which a taxpayer was not allowed to add the period for which he held an option to buy certain land to the period of holding the land; *Howell v. Commissioner*, 140 F. 2d 765 (C. C. A. 5th), holding that the period in which a lease was held in escrow could not be added to the period extending from delivery of the lease to its sale; *Sommers v. Commissioner*, 63 F. 2d 551 (C. C. A. 10th), in which it was held that the period for holding stock dates from its issue rather than the date it was subscribed for; and *Commissioner v. C. A. Spurl & Co.*, 118 F. 2d 283 (C. C. A. 5th), in which the holding period was held to begin with the date when the taxpayer relinquished its rights as a general creditor and agreed to accept bonds for the unpaid portion of the debt.

We submit that these cases, while obviously referring to different situations, indicate that counsel for taxpayer is in error in implying that a taxpayer may add various periods together to meet the statu-

tory requirements here involved. Instead, when there is a change in the nature of the property, the period for which the particular kind of property has been held may not be added to the holding period for another kind of property, although closely related to the first.

In the instant case, the taxpayer acquired notes which were not registered and then returned them in 1940 to have them put in registered form. This change was not inconsequential and should not be passed over lightly. The purpose of registration is well known and important. It is a protection to the owner against theft and provides him with a proper and safe way of transferring his holdings. *Gerard v. Helvering*, 120 F. 2d 235 (C. C. A. 2d); 3 Thompson on Corporations (3d Ed.), Sec. 2344. Congress was of course aware of the difference between registered and unregistered evidences of indebtedness and clearly intended to extend the provisions of Section 117 (f) only to persons who had held notes in registered form for the period required by subsection (b).

*Gracey v. Commissioner*, 5 T. C. 296, now pending on the Government's appeal to the Circuit Court of Appeals for the Fifth Circuit, involves subsection (h) (1) of Section 117, which, since it refers only to property acquired in connection with a nontaxable exchange, has no application here. Thus that decision, though now being contested by the Government, can have no bearing on this case.

Accordingly, we submit that, when full effect is given to the language of Section 117 (f), and it is read

and considered with the remainder of Section 117, as it should be, it clearly appears that the notes here do not meet the statutory requirements and that the gain realized on their retirement must be included in its entirety in gross income.

#### CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted.

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JANUARY 1946.

No. 11,160

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

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BABETTE G. LURIE,

*Petitioner,*

VS.

COMMISSIONER OF INTERNAL REVENUE,

*Respondent.*

PETITIONER'S REPLY BRIEF.

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FILED

FEB - 9 1946

PAUL P. O'BRIEN,  
- CLERK



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### SUMMARY OF ARGUMENT.

(1) Respondent contends that the notes must be in registered form when originally issued. It will be shown that the definition of the word "issued" and the grammatical construction of section 117(f) strongly support taxpayer's position that respondent's contention is unsound. It will also be shown that in any event under section 117(h)(1) respondent's contention does not affect the determination of the case.

(2) In taxpayer's opening brief the issues were clearly defined. It will be demonstrated that the respondent's arguments do not meet the issues and that the authorities cited do not support his position.

## ARGUMENT.

## I.

AT THE TIME OF THE RETIREMENT OF THE NOTES IN QUESTION THEY WERE ISSUED BY A CORPORATION AND WERE IN REGISTERED FORM AND THUS FALL WITHIN THE TERMS OF SECTOIN 117(f) OF THE INTERNAL REVENUE CODE, REGARDLESS OF THE FACT THAT THEY WERE NOT IN REGISTERED FORM WHEN ORIGINALLY ISSUED.

- (a) By definition of the word "issued", notes need not be in registered form when originally issued.

In the case of *Yale Petroleum Company v. Commissioner*, 2 T. C. 1039, the question arose as to whether a mortgage of incorporators of a corporation which was adopted by a corporation was a mortgage "issued by the corporation and in existence at the close of business on December 31, 1937, under Section 27(a)(4), Revenue Act of 1939". Under said section, payments on said types of obligations constituted a credit for undistributed profits tax purposes. The Court said:

"Was the mortgage upon which the petitioner made the payment in 1938 of \$95,000. one 'issued' by petitioner within the meaning of that word as used in section 27(a)(4), Revenue Act of 1938? We think it was. Once petitioner adopted the contract and mortgage of February 12, 1937, as its own, as it clearly did on April 15, 1937, petitioner was as firmly bound thereby as though it had signed the original contract and mortgage. The signing of a new contract and the issuing of a new mortgage by petitioner would have been a useless gesture under the authorities we have cited. Therefore, we think it is correct to hold that by virtue of petitioner's adoption on April 15, 1937, of the contract and mortgage of its promoters, the

mortgage became one 'issued' by petitioner on April 15, 1937, within the intendment of the statute. The statute says that in order to get the dividends paid credit the mortgage must have been one 'issued' by the corporation and in existence at the close of business on December 31, 1937. Under our interpretation as above set out, the mortgage involved in the instant case meets the above test."

The words "issued by a corporation" cannot be so restricted as to refer to the original issue of an obligation but refer to a situation where obligations of a corporation are existing at the time referred to in the law—in the cited case December 31, 1937, in the instant case at the time of retirement.

- (b) The grammatical construction of section 117(f) negatives an interpretation that the notes must be in registered form at the time of issuance in order to fall within its terms.**

Eliminating from section 117(f) of the Internal Revenue Code the portions thereof not material to the instant case, the section reads as follows:

"For the purposes of this chapter, amounts received by the holder upon retirement of notes issued by any corporation, with interest coupons or in registered form, shall be considered as amounts received in exchange therefor."

To give to the section the meaning which the respondent seeks to attach to it, it must necessarily read as follows:

"For the purposes of this chapter, amounts received by the holder upon the retirement of notes issued with interest coupons or in registered form

by any corporation shall be considered as amounts received in exchange therefor.”

The very fact that the phrase “with interest coupons or in registered form” is set apart in commas prevents the construction sought by the respondent. The fact that the phrase does not follow the word “issued” likewise defeats the respondent’s contention. There is nothing in the language of the section which indicates that it was the intention of Congress that this phrase should modify the word “issued”. Rather it is merely a description of notes, the retirement of which shall be considered an exchange.

It is of especial significance that when respondent quotes what he claims is the “decisive portion” of section 117(f) (Res. Br. p. 10) he most carefully eliminates the punctuation which so clearly demonstrates that taxpayer’s construction is correct.

There is no justification for the respondent’s attempted disregard of the clear language of the statute. In fact, carrying his attempted construction to a conclusion would result in an absurdity. For example, if a corporation issued notes in unregistered form, which notes were returned and registered within a short period thereafter and, years later, were acquired by a taxpayer and subsequently retired, under the respondent’s contention said retirement would not constitute an exchange even though the taxpayer or any other then holder of any of said notes were unalive to the fact that they were at any time not in registered form. Every purchaser of every bond would have to

ascertain the original form of issue in order to determine whether the retirement constituted an exchange even though the bonds may have been issued decades before acquisition. There is certainly nothing in the statute warranting a construction that the form at the time of acquisition is material.

(c) **The construction placed upon section 117(f) by the taxpayer is in accordance with its purpose.**

As explained in taxpayer's opening brief (pp. 11, 12) the obvious purpose of the section compels the conclusion that the taxpayer's construction of section 117(f) is correct.

(d) **A reissuance of notes in registered form satisfies section 117(f).**

Respondent concedes that the instant notes were *re-issued* in registered form, and that *their determining character may date from the reissuance*. (Res. Br. p. 15.) Assuming that these notes were reissued when they were converted to registered form and therefore fall within section 117(f), then the period for which taxpayer held the notes relates back to the time of the original purchase under section 117(h)(1). (See II(d), p. 13, *infra*.)

## II.

**THE RESPONDENT HAS FAILED TO ANSWER THE  
CONTENTIONS OF TAXPAYER.**

Taxpayer endeavored in her opening brief to clarify the issues by pointing out (a) that the notes in question were admittedly capital assets; (b) that said notes were admittedly held by taxpayer for more than two years; and (c) that therefore the sole question was whether or not the retirement thereof constituted a sale or exchange under section 117(f).

Taxpayer will demonstrate that the issues originally outlined by her remain unanswered.

**(a) The upholding of taxpayer's contention does not permit of tax avoidance.**

Respondent contends and quotes from the Tax Court's opinion that last-minute registration would allow taxpayers to choose their time for registration and thus determine for themselves whether or not they desired to treat the transaction as an ordinary gain or loss or as a capital gain or loss and that such a construction would not be imputed to Congress. (Res. Br. p. 13.) Section 117(f) refers only to notes in registered form and whether or not the notes are registered by the holders is of no consequence. This fact was called to the Court's attention in taxpayer's opening brief at page 14 but has been ignored by the respondent who falls into the same error as did the Tax Court.

Assuming that respondent meant that a taxpayer could determine his position by causing the notes to be converted to registered form (the form being the

only issue under section 117(f)) still the argument is without merit. The control exists in any event. If a person owns an unregistered note and desires to take an ordinary loss he can allow the note to be paid or retired. If he desires to turn the transaction into a capital one he can sell the note even though a day before retirement. Section 117(f) neither adds to nor subtracts from this alternative. This argument was presented by taxpayer in her opening brief (p. 14) and again respondent has failed to meet the issue. (It should be again pointed out that there is no evidence or contention that the conversion of the notes in the instant case into registered form by the issuer, Hilton Hotel Company of California, was for the purpose of tax avoidance.)

Contrary to respondent's contention, no congressional intent favoring respondent can be gathered from the supposed option which a taxpayer may have when that same option exists regardless of the construction placed upon the statute.

**(b) Reading all subdivisions of section 117(f) together compels the conclusion that the period during which the notes were in registered form has no application to section 117(f).**

At the risk of being repetitive the taxpayer in her opening brief (pp. 8 et seq.) endeavored to present the issue in simplified form and to analyze completely all provisions of section 117 applicable to the instant case. Taxpayer is now accused by respondent of endeavoring to deny that subsection (f) must be read or considered with the other provisions of section 117. (Res. Br. pp. 10, 12.) Respondent argues in line with the opinion of

the Tax Court that "to come within section 117(f) the notes must be in the very least, in registered form for the minimum period provided by section 117(b)". (T. p. 21, quoted in Opening Brief, p. 10.) For some reason respondent and the Tax Court are prepared to read only one portion of section 117(b). This section reads as follows:

"(b) Percentage Taken Into Account.—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

100 per centum if the capital asset has been held for more than 18 months;

66 $\frac{2}{3}$  per centum if the capital asset has been held for more than 18 months but not for more than 24 months;

50 per centum if the capital asset has been held for more than 24 months."

It merely holds that certain percentages of profit are taken into account dependent upon the holding period. It does not state that if the asset is held for more than 18 months a long term capital gain or loss results while if it is held for less than 18 months the profit is ordinary income. In either instance the profit or loss is a capital gain or loss. True, under section 117(a)(2) and 117(a)(4) (quoted in Taxpayer's Opening Brief, p. 8) if an asset is held for less than 18 months the profit is a short term capital gain and if held for more than 18 months the profit is a long term capital gain.



It is inconceivable how an argument can be made that section 117 in its entirety provides that retirement of a note which was in registered form for more than 18 months results in a long term capital gain while retirement of such a note which is held for less than 18 months constitutes ordinary income and not a short term capital gain. Nevertheless this argument has been expressly made by the Tax Court and respondent. As the Tax Court stated: "Since petitioner's notes were in registered form for less than \* \* \* [18 months] before retirement they do not qualify under section 117(f)" (T. p. 21, quoted in Taxpayer's Opening Brief, p. 10) and as stated by respondent "Congress \* \* \* clearly intended to extend the provisions of section 117(f) only to persons who had held notes in registered form for the period required by subsection (b)"; but subsection (b) does not provide for any period. By referring to capital assets held for not more than 18 months and to capital assets held for more than 18 months it necessarily applies to all capital assets.

Again we have an argument which was presented in taxpayer's opening brief (p. 10) and again respondent has failed to respond thereto.

In taxpayer's opening brief, at page 10, the question was posed, an example of which follows: Suppose a taxpayer purchased ordinary coupon bonds issued for \$110 per \$100 face value and three months later said bonds were called and retired, would the respondent claim that the result was an ordinary loss and not a capital loss because section 117(f) does not apply to capital assets which are not held in the prescribed form

for more than 18 months? Certainly the law would require clearly that the loss would be a short term capital loss. Despite the fact that this question was presented in taxpayer's opening brief we find it ignored by respondent who blithely states that section 117(f) does not apply unless the asset is in the form prescribed for at least 18 months. We certainly cannot have one interpretation when a profit arises and another when a loss is incurred.

Since it is definite that section 117(f) applies to all capital assets which are in registered form or with coupons attached and since said section provides that the retirement of such an asset constitutes a sale or exchange the only question remaining is whether or not in the instant case there was a long term capital gain or a short term capital gain. To determine that question we look to section 117(a)(4) which provides in part: "The term 'long term capital gain' means gain from the sale or exchange of a capital asset held for more than 18 months." It is conceded that the notes in question were capital assets held for more than 18 months. Therefore the taxpayer is entitled to a long term capital gain.

**(c) The authorities do not support respondent's contention.**

While admittedly there is no case exactly in point, in taxpayer's opening brief (p. 12) it was pointed out that the question of determining the effect of a sale or exchange of an asset is controlled by the conditions in existence at the date of the sale or exchange. Counsel for respondent takes issue (Res. Br. p. 14) because

we are not dealing here with a sale or exchange but with a retirement. The very section in question (section 117(f)) provides that the retirement shall be considered as an exchange and therefore the respondent's point is without moment. If counsel prefers we shall state that the question of determining the effect of a sale or exchange or retirement of an asset is controlled by the conditions in existence at the date of the sale or exchange or retirement.

In I.T. 3041, 1927-1, C.B. 148 (followed in *Kimbell v. Commissioner*, 41 B.T.A. 940), referred to in taxpayer's opening brief, page 12, it is recognized that the holding period for residential properties subsequently converted into business property commenced not at the time of the conversion but at the time of the original acquisition. Under the law if a house used as a residence is sold at a loss the loss is not allowed. If converted to a business purpose and then sold the loss became, under the law as it then stood, a capital loss if held for two years. The question arose as to the holding period, and it was determined that the period relates to the time of the original acquisition of the property. Counsel distinguishes this case by stating that "of course a house is a capital asset regardless of what kind of property it is". Counsel apparently intimates that the notes in question were not capital assets during the entire period of time they were held by the taxpayer. Of course the notes are unquestionably capital assets for under our present law, as pointed out in taxpayer's opening brief at page 7, all classes of property not specifically excluded are capital assets and notes are not excluded.

Respondent then cites five cases which admittedly refer to different situations, but contends that they indicate that various periods cannot be added together to meet the statutory requirements of section 117. A very brief analysis of those cases will disclose that not only do they refer to different situations but also they do not in any manner support respondent's contention.

In the case of *In re Rogers Estate*, 143 F. (2d) 695 (C.C.A. 2d), certiorari denied 323 U. S. 780, stock was sold and paid for by promissory notes payable in installments. Section 117 applied at the time of the sale of the stock and the fact that the notes were payable over a long period of time after the sale could not affect the consummated sale.

The case of *Helvering v. San Joaquin Co.*, 297 U. S. 496, did not deal with the holding period but merely held that the cost basis of real property is determined at the time of purchase and not at the time of the execution of a prior lease, which contained an option to purchase.

In *Howell v. Commissioner*, 140 F. (2d) 765 (C.C.A. 5th), the Court held that the holding period commenced when a lease (which was held in escrow upon certain conditions) was delivered and became effective.

In *Sommers v. Commissioner*, 63 F. (2d) 551 (C.C. A. 10th), stock was subscribed for but the Court held that the corporation was not bound by the agreement and therefore the holding period commenced when the taxpayer first acquired the stock.

It is clear that none of the foregoing cases has any relation to a situation where one capital asset was held during the entire holding period.

The last case cited by respondent is *Commissioner v. C. A. Spurl & Co.*, 118 F. (2d) 283 (C.C.A. 5th), in which case it is held that the holding period of certain bonds commenced when a creditor surrendered his right as such and an unconditional agreement was reached to accept bonds even though the bonds were not issued for four months thereafter. While this latter case is not especially material it lends some support to taxpayer's (not respondent's) contention.

**(d) Under section 117(h)(1) taxpayer is entitled to a long term capital gain.**

Internal Revenue Code section 117(h)(1) provides as follows:

“(h) Determination of Period for Which Held.—For the purpose of this section—

1. In determining the period for which the taxpayer has held property received on an exchange there shall be included the period for which he held the property exchanged, if under the provisions of section 113, the property received has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in his hands as the property exchanged.”

In taxpayer's opening brief at page 13 it was pointed out that when a capital asset has been exchanged in a non-taxable exchange the holding period commences under subsection 117(h)(1) at the time of the acquisition of the original asset.

The case of *Gracey v. Commissioner*, 5 T. C. 296, was cited in which the Tax Court held that even though the asset were not a capital asset but was converted into a capital asset by a non-taxable exchange and then sold a few months later, the sale of the asset resulted in a long term capital gain. Once again respondent failed to meet the issue but merely states (Res. Br. p. 17) that the *Gracey* case is on appeal and has no application to the instant case since it refers only to property acquired in connection with a non-taxable exchange. The *Gracey* case is on appeal, presumably because there was no capital asset in existence for more than three months. In the instant case there was a capital asset held by the taxpayer for more than two years and therefore if the conversion of the notes into registered form constituted a non-taxable exchange the *Gracey* case is applicable and in any event the situation would fall directly under section 117(h)(1).

As previously pointed out, respondent contends that the conversion to registered form constituted a reissuance of the notes. (Res. Br. p. 15.) Necessarily the calling of all of the notes by the corporation and the "reissuance" in registered form of all of said notes would be a mere recapitalization and a non-taxable exchange, and no contention is made by the respondent that such exchange was taxable in the year the notes were converted into registered form. If the conversion into registered form amounted to a reissuance as respondent contends then there can be no question but that the taxpayer is entitled to a long term capital gain inasmuch as the case would fall directly under section 117(h)(1).

On the other hand, if there were no exchange and the original asset was held during the entire two year period then the taxpayer's case is even stronger. Certainly if the notes were exchanged and taxpayer was entitled to a long term capital gain it cannot be seriously contended that when the notes were not even exchanged the taxpayer must return the entire profit. No doubt the reason that respondent failed to meet this issue was because no conceivable explanation could be given for holding that a more harsh situation results to a taxpayer when the original asset is held for two years than where the asset is exchanged during the period for a new one.

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#### CONCLUSION.

It is submitted that the notes in question come directly within Internal Revenue Code section 117(f) and that the Tax Court erred in endeavoring to read into the section that which does not exist, namely, that a note must be in registered form for a specified period of time in order for that section to be effective.

Dated, San Francisco, California,

February 8, 1946.

Respectfully submitted,

OSCAR SAMUELS,

TEVIS JACOBS,

*Attorneys for Petitioner.*





No. 11165

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United States  
Circuit Court of Appeals  
For the Ninth Circuit.

---

EDGAR RUGGIERO and AMERIGO  
BELLUOMINI,

Appellants,

vs.

UNITED STATES OF AMERICA

Appellee.

---

Transcript of Record

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Upon Appeal from the District Court of the United States  
for the Northern District of California,  
Southern Division

FILED  
MAR 20 1946

PAUL P. O'BRIEN,  
CLERK



No. 11165

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United States  
Circuit Court of Appeals

For the Ninth Circuit.

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EDGAR RUGGIERO and AMERIGO  
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Transcript of Record

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Upon Appeal from the District Court of the United States  
for the Northern District of California,  
Southern Division

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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FRANK J. HENNESSY,

United States Attorney,

Northern District of California,

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San Francisco, California,

Attorney for Appellee.

In the Southern Division of the United States  
District Court for the Northern District of  
California

No. 29633-R

UNITED STATES OF AMERICA,

Plaintiff,

vs.

AMERIGO BELLUOMINI,

Defendant.

## INFORMATION

### FIRST COUNT

(Second War Powers Act, Title III, Section 301,  
Public Law 507, 77th Congress; Title 50  
U.S.C.A. App., Section 633.)

Leave of Court being first had, Frank J. Hennessy, United States Attorney for the Northern District of California, comes, and for the United States of America informs this Court: That Amerigo Belluomini, (hereinafter called "said defendant"), did, on or about the 7th day of May, 1945, in the City and County of San Francisco, State of California, within the Southern Division of the Northern District of California, and within the jurisdiction of this Court, wilfully and unlawfully acquire, possess and control certain counterfeited and forged ration documents, to-wit: 5000 red meat ration stamps, under circumstances [1\*] which

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\* Page numbering appearing at foot of page of original certified Transcript of Record.

would be in violation of Section 2.6 of General Ration Order No. 8 if the said counterfeited and forged ration documents were genuine, that is to say, the said defendant was not then and there, or at any time, a person, or the agent of a person, to whom said ration documents were issued, or by whom said ration documents were acquired in accordance with the provisions of any Ration Order, or a person, or the agent of a person by whom said ration documents were acquired, possessed and controlled as otherwise provided by any Ration Order. (General Ration Order No. 8, Sections 2.5 and 2.6; 8 F. R. 3783; General Ration Order No. 14; 8 F. R. 14211; General Ration Order No. 16, 9 F. R. 6731.)

## SECOND COUNT

(Second War Powers Act, Title III, Section 301, Public Law 507, 77th Congress; Title 50 U.S.C.A. App. Section 633.)

And the said United States Attorney for the Northern District of California further informs this Court:

That said defendant, Amerigo Belluomini, on or about the 23rd day of May, 1945, in the City and County of San Francisco, State of California, within the Southern Division of the Northern District of California, and within the jurisdiction of this Court, did unlawfully, wilfully and knowingly transfer to one Leondro Messaglia certain counterfeited and forged ration documents, to-wit: 2500 red meat ration stamps, under circumstances, which

would be in violation of Section 2.6 of General Ration Order No. 8 if the said counterfeited and forged ration documents were genuine, that is to say, the said defendant did then and there transfer said 2500 red meat ration stamps to the said Leonardo Messaglia otherwise than in a way permitted and otherwise than for a purpose permitted by any Ration Order. (General Ration Order No. 8, [2] Sections 2.5 and 2.6; 8 F. R. 3783; General Ration Order No. 14; 8 F. R. 14211; General Ration Order No. 16; 9 F. R. 6731.)

### THIRD COUNT

(Second War Powers Act, Title III, Section 301, Public Law 507, 77th Congress; Title 50 U.S.C.A. App., Section 633.)

And the said United States Attorney for the Northern District of California further informs this Court:

That the said defendant, Amerigo Belluomini, on or about the 9th day of May, 1945, in the City and County of San Francisco, State of California, within the Southern Division of the Northern District of California, and within the jurisdiction of this Court, did unlawfully, wilfully and knowingly transfer to one Bank of America National Trust and Savings Association, 37th Avenue and Balboa Street Branch, San Francisco, California, certain counterfeited and forged ration documents, to-wit: 2500 red meat ration stamps, under circumstances which would be in violation of Section 2.6 of General Ration Order No. 8 if the said counterfeited

and forged ration documents were genuine, that is to say, the said defendant did then and there transfer said 2500 meat ration stamps to the said Bank of America National Trust and Savings Association, 37th Avenue and Balboa Street Branch, San Francisco, California, otherwise than in a way permitted and otherwise than for a purpose permitted by any Ration Order. (General Ration Order No. 8, Sections 2.5 and 2.6; 8 F. R. 3783; General Ration Order No. 14; 8 F. R. 14211; General Ration Order No. 16; 9 F. R. 6731.)

(Signed) FRANK J. HENNESSY

United States Attorney [3]

United States of America,  
State and Northern District of California,  
City and County of San Francisco—ss.

James O. Reimel, being first duly sworn, deposes and says: That he is an Investigator employed by the Office of Price Administration; that he has read the foregoing information; that he is familiar with the facts therein alleged concerning the offenses therein described, and that the same are true of his own knowledge.

JAMES O. REIMEL

Subscribed and sworn to before me this 30th day of July, 1945.

[Seal]

M. E. VAN BUREN

Deputy Clerk, U. S. District Court, Nor. Dist. of  
California

[Endorsed]: Presented in Open Court and  
Ordered Filed July 31, 1945. [4]

In the Southern Division of the United States  
District Court for the Northern District of  
California

No. 29635-R

UNITED STATES OF AMERICA,

Plaintiff,

vs.

EDGAR RUGGIERO,

Defendant.

### INFORMATION

### FIRST COUNT

(Second War Powers Act, Title III, Section 301,  
Public Law 507, 77th Congress; Title 50  
U.S.C.A. App., Section 633.)

Leave of Court being first had, Frank J. Hennessy, United States Attorney for the Northern District of California, comes, and for the United States of America informs this Court: That Edgar Ruggiero, (hereinafter called "said defendant"), did, on or about the 7th day of May, 1945, in the City and County of San Francisco, State of California, within the Southern Division of the Northern District of California, and within the jurisdiction of this Court, wilfully and unlawfully acquire, possess and control certain counterfeited and forged ration documents, to-wit: 8700 red meat ration stamps, under circumstances which would be in violation of Section 2.6 of General Ration Order No. 8 if the said counterfeited and forged ration

documents were genuine, that is to say, the said defendant was not then and there, or at any time, a person, or the agent of a person, to whom said ration documents were issued, or by whom said ration documents were acquired in accordance with the provisions [5] of any Ration Order, or a person, or the agent of a person by whom said ration documents were acquired, possessed and controlled as otherwise provided by any Ration Order. (General Ration Order No. 8, Sections 2.5 and 2.6; 8 F. R. 3783; General Ration Order No. 14, 8 F. R. 14211; General Ration Order No. 16, 9 F. R. 6731.)

## SECOND COUNT

(Second War Powers Act, Title III, Section 301, Public Law 507, 77th Congress; Title 50 U.S.C.A. App., Section 633.)

And the said United States Attorney for the Northern District of California further informs this Court:

That the said defendant, Edgar Ruggiero, on or about the 7th day of May, 1945, in the City and County of San Francisco, State of California, within the Southern Division of the Northern District of California, and within the jurisdiction of this Court, did unlawfully, wilfully and knowingly transfer to one Amerigo Belluomini certain counterfeited and forged ration documents, to-wit: 5000 red meat ration stamps, under circumstances which would be in violation of Section 2.6 of General Ration Order No. 8 if the said counterfeited and

forged ration documents were genuine, that is to say, the said defendant did then and there transfer said 5000 red meat ration stamps to the said Amerigo Belluomini otherwise than in a way permitted and otherwise than for a purpose permitted by any Ration Order. (General Ration Order No. 8, Sections 2.5 and 2.6; 8 F. R. 3783; General Ration Order No. 14, 8 F. R. 14211; General Ration Order No. 16, 9 F. R. 6731.)

### THIRD COUNT

(Second War Powers Act, Title III, Section 301, Public Law 507, 77th Congress; Title 50 U.S.C.A. App., Section 633.)

And the said United States Attorney for the Northern District of California further informs this Court:

That the said defendant, Edgar Ruggiero, on or about the 7th day of May, 1945, in the City and County of San Francisco, State of California, within the Southern Division of the Northern District of California, and within the jurisdiction of this Court, did unlawfully, wilfully and knowingly transfer to one Bank of America National Trust and Savings Association, West Portal Branch, San Francisco, California, certain counterfeited and forged ration [6] documents, to-wit: 3780 red ration meat stamps, under circumstances which would be in violation of Section 2.6 of General Ration Order No. 8 if the said counterfeited and forged ration documents were genuine, that is to say, the said



defendant did then and there transfer said 3780 red ration meat stamps to the said Bank of America National Trust and Savings Association, West Portal Branch, San Francisco, California, otherwise than in a way permitted and otherwise than for a purpose permitted by any Ration Order. (General Ration Order No. 8, Section 2.5 and 2.6; 8 F. R. 3783; General Ration Order No. 14, 8 F. R. 14211; General Ration Order No. 16, 9 F. R. 6731.)

(Signed) FRANK J. HENNESSY

United States Attorney

United States of America,  
State and Northern District of California,  
City and County of San Francisco—ss.

James O. Reimel, being first duly sworn, deposes and says: That he is an Investigator employed by the Office of Price Administration; that he has read the foregoing Information; that he is familiar with the facts therein alleged concerning the offenses therein described, and that the same are true of his own knowledge.

JAMES O. REIMEL

Subscribed and sworn to before me this 30th day of July, 1945.

[Seal]

M. E. VAN BUREN

Deputy Clerk, U. S. District Court, Nor. Dist. of  
California

[Endorsed]: Presented in Open Court and  
Ordered Filed July 31, 1945. [7]

[Title of District Court and Cause—No. 2933-R.]

### DEMURRER TO INFORMATION

Now comes Amerigo Belluomini, the defendant in the cause entitled as above, and demurs to the information on file herein and to each of the several counts thereof, and says that the matters and things in said information and in each of the several counts thereof alleged are insufficient in law to require this defendant to answer thereto, for each of the following reasons, to-wit:

#### I.

That the said First Count of said Information does not state facts sufficient to charge this defendant with any crime or offense against the United States.

#### II.

That said First Count of said Information is bad for uncertainty in each of the following particulars, to-wit:

(a) That the said First Count alleges that the said defendant [8] did wilfully and unlawfully acquire, possess and control certain counterfeited and forged ration documents, but that the said documents are not, nor is any of said documents, set forth either according to its tenor or according to its purport;

(b) That it cannot be ascertained therefrom whether the documents alleged to have been counterfeited and forged were counterfeits or forgeries of any documents issued by the United States of

America or by any department, agency, board or officer thereof having authority to issue the same;

(c) That it cannot be ascertained therefrom how or in what manner said defendant was not a person or the agent of a person by whom said ration documents were acquired in accordance with the provisions of any ration order, or a person or the agent of a person by whom said ration documents were acquired, possessed or controlled as otherwise provided by any ration order;

(d) That it cannot be ascertained therefrom how or in what manner the said defendant violated any provision of any so-called ration order.

### III.

That the said Second Count of said Information does not state facts sufficient to charge this defendant with any crime or offense against the United States.

### IV.

That said Second Count of said Information is bad uncertainty in each of the following particulars, to-wit:

(a) That the said Second Count alleges that the said defendant did unlawfully, wilfully and knowingly transfer certain counterfeited and forged ration documents, but the said documents are not, nor is any of said documents, set forth either according to its tenor or according to its purport;

(b) That it cannot be ascertained therefrom whether the documents alleged to have been coun-

terfeited and forged were counterfeits or forgeries of any documents issued by the United States of America or by any department, agency, board or officer thereof having authority to issue the same;

(c) That it cannot be ascertained therefrom how or in what manner the transfer of the so-called meat ration stamps therein referred to was otherwise than in a way permitted or otherwise than for a purpose permitted by any ration order.

(d) That it cannot be ascertained therefrom how or in what manner the said defendant violated any provision of any so-called ration order.

## V.

That the said Third Count of said Information does not state facts sufficient to charge this defendant with any crime or offense against the United States.

## VI.

That said Third Count of said Information is bad for uncertainty in each of the following particulars, to-wit:

(a) That the said Third Count alleges that the said defendant did unlawfully, wilfully and knowingly transfer to one Bank of America National Trust and Savings Associations, 37th Avenue and Balboa Street Branch, San Francisco California, certain counterfeited and forged ration documents, set forth either according to its tenor or according to its purport.

(b) That it cannot be ascertained therefrom

whether the documents alleged to have been counterfeited and forged were counterfeits or forgeries of any documents issued by the United States of America or by any department, agency, board or officer thereof having authority to issue the same;

(c) That it cannot be ascertained therefrom how or in what manner the transfer of the so-called meat ration stamps therein referred to as alleged in said count was otherwise than in a way permitted or otherwise than for a purpose permitted by any ration order;

(d) That it cannot be ascertained therefrom how or in what manner the said defendant violated any provision of any so-called ration order. [10]

## VII.

That this honorable court has no jurisdiction of the above entitled cause or to hear or determine the said information, or to try this defendant thereon or as to any count thereof, for the reason that General Ration Order 8 is unconstitutional and void, and that no criminal prosecution will lie for any alleged violation of any of the provisions of said order, for the reason that section 3.1 of Article III of said General Ration Order purports and attempts to punish the violation of the said order or any other ration order as a crime and fixes the penalty therefor; and that the Price Administrator has no power to declare what acts shall be criminal or shall constitute crimes, or to determine the punishments for any act; that no statute of the United States, and no act of Congress, confers upon

the Price Administrator the power to define or to punish crimes, and that if any act of Congress can be construed as an authorization to said Price Administrator to define and punish crimes, or to declare that any act shall constitute a crime and fix the punishment therefor, such Act is to that extent unconstitutional and void, and in violation of the provision of the Fifth Amendment to the Constitution of the United States that no person shall be deprived of life, liberty or property without due process of law, and is an unlawful delegation of legislative powers which are vested by the constitution of the United States in the Congress alone.

Wherefore, said defendant prays that this Demurrer be sustained and that defendant go hence without day.

(Signed) WILLIAM PETROS

Attorney for Defendant,

Wm. E. Ferriter.

(Here follows points and authorities in support of Demurrer.)

[Endorsed]: Filed Aug. 21, 1945. [11]

District Court of the United States, Northern  
District of California, Southern Division

At a Stated Term of the Southern Division of  
the United States District Court for the Northern  
District of California, held at the Court Room  
thereof, in the City and County of San Francisco,  
on Tuesday the 14th day of August, in the year of  
our Lord one thousand nine hundred and forty-  
five.

Present: The Honorable A. F. St. Sure, District  
Judge, sitting for and on behalf of Honorable Louis  
E. Goodman, District Judge.

[Title of Cause.—No. 29635-R.]

ORDER ENTERING DEFENDANT'S PLEA  
OF NOT GUILTY

This case came on regularly this day to plead.  
The defendant, Edgar Ruggiero, was present in  
proper person and with his attorney, Walter  
Duane, Esq. Reynold H. Colvin, Esq., Assistant  
United States Attorney, was present on behalf of  
the United States.

The defendant was called to plead and thereupon  
said defendant pleaded "Not Guilty" to the Infor-  
mation filed herein against him, which said plea  
was ordered entered. Defendant requested trial  
by jury. After hearing the attorneys, it is ordered  
that this case be continued to August 21, 1945, to  
be set for trial. [12]

District Court of the United States, Northern  
District of California, Southern Division

At a Stated Term of the Southern Division of  
the United States District Court for the Northern  
District of California, held at the Court Room  
thereof, in the City and County of San Francisco,  
on Monday, the 27th day of August, in the year of  
our Lord one thousand nine hundred and forty-  
five.

Present: The Honorable A. F. St. Sure, District  
Judge, sitting for and on behalf of Honorable  
Michael J. Roche, District Judge.

[Title of Cause—No. 29635-R.]

ORDER ENTERING DEFENDANT'S PLEA  
OF NOT GUILTY AND OVERRULING  
DEMURRER TO INFORMATION

This case came on regularly this day for entry  
of plea and hearing on demurrer to Information.  
The defendant Amerigo Belluomini was present in  
proper person and with his attorney, Wm. Ferriter,  
Esq. Reynold H. Colvin, Esq., Assistant United  
States Attorney, was present on behalf of the  
United States.

The defendant was called to plead and thereupon  
said defendant pleaded "Not Guilty" to the Infor-  
mation filed herein against him, which said plea  
was ordered entered.

After hearing the attorneys, It Is Ordered that  
the demurrer to Information be and the same is  
hereby overruled.

Further ordered that this case be continued to  
September 11, 1945, to be set for trial. [13]



District Court of the United States, Northern  
District of California, Southern Division

At a Stated Term of the Southern Division of  
the United States District Court for the Northern  
District of California, held at the Court Room  
thereof, in the City and County of San Francisco,  
on Tuesday, the 9th day of October, in the year  
of our Lord one thousand nine hundred and forty-  
five.

Present: The Honorable Michael J. Roche,  
District Judge.

[Title of Causes—Nos. 29633 and 29635.]

### MINUTES OF TRIAL BY COURT AND CONVICTION

These two cases came on regularly this day for  
trial before the Court sitting without a jury, a  
trial by jury having been heretofore waived. The  
defendant Amerigo Belluomini was present with  
William Ferriter, Esq., and William Petros, Esq.,  
his attorneys. The defendant Edgar Ruggiero was  
present with Walter Duane, Esq., his attorney.  
Reynold H. Colvin, Esq., Assistant United States  
Attorney, was present on behalf of the United  
States.

By stipulation, it is Ordered that these two cases  
be consolidated for trial. Mr. Colvin and Mr.  
Ferriter made [14] their respective opening state-  
ments to the Court. E. W. Slade and James Reimel  
were each sworn and testified on behalf of the  
United States. Mr. Colvin introduced in evidence

and filed U. S. Exhibits 1-A, 1-B, 1-C, 1-D, 1-E, 1-F, 1-G, 1-H, 2-A, 2-B, 2-C, 2-D, 2-E, 3 and 4; and thereupon the United States rested. Mr. Ferriter made a motion to dismiss the Informations, which motion, after hearing Mr. Ferriter and Mr. Colvin, was ordered denied. Edgar Ruggiero and Amerigo Belluomini were each sworn and testified in their own behalf. Mr. Duane introduced in evidence and filed Defendant's Exhibit A. The defendants then rested. The evidence being closed, and the case being submitted and fully considered, it is Ordered that the defendants Amerigo Belluomini and Edgar Ruggiero be, and each is hereby adjudged guilty as charged in the Informations.

Mr. Duane and Mr. Ferriter each made a motion to refer these cases to the Probation Officer, whereupon it is Ordered that these two cases be referred to the Probation Officer of this Court for a presentence investigation.

Ordered that these cases be continued to October 12, 1945, for pronouncing of judgment. Further ordered that the defendants be remanded to the custody of the United States Marshal to await judgment and that mittimus issue herein. [15]

District Court of the United States, Northern  
District of California, Southern Division

At a Stated Term of the Southern Division of the United States District Court for the Northern District of California, held at the Court Room thereof, in the City and County of San Francisco, on Friday the 12th day of October, in the year of our Lord one thousand nine hundred and forty-five.

Present: The Honorable Michael J. Roche,  
District Judge.

[Title of Causes—Nos. 29633, 29635.]

SENTENCE

These cases came on regularly this day for the pronouncing of judgment. The defendants were present in the custody of the United States Marshal and with their respective attorneys: William Ferriter, Esq., for defendant Amerigo Belluomini; and Walter Duane, Esq., for defendant Edgar Ruggiero. Reynold H. Colvin, Esq., Assistant United States Attorney, was present on behalf of the United States. M. T. Curran, Probation Officer, was present.

The defendants were called for judgment. After hearing the attorneys, and due consideration having been had on the report of the Probation Officer, and the said defendants having been now asked whether they have anything to say why [16] judgment should not be pronounced against them, and no sufficient cause to the contrary being shown or appearing to the Court, It Is By the Court

Ordered and Adjudged that the said defendants Ameriga Belluomini and Edgar Ruggiero, having been adjudged guilty by the Court of the offenses charged in the Information filed in the above entitled cases, be and each is hereby committed to the custody of the Attorney General or his authorized representative for imprisonment for the period of Six (6) Months on each of Counts One, Two and Three of the Information and pay a fine to the United States of America in the sum of One Thousand (\$1,000.00) Dollars on each of Counts One, Two and Three of the Information, making a total fine of Three Thousand (\$3,000.00) Dollars, and in default of payment of fine that the defendant so in default be further imprisoned until payment of said fines or until said defendant is otherwise discharged as provided by law.

It Is Further Ordered that the sentences of imprisonment imposed on defendant in this case on Counts One, Two and Three of the Information commence and run concurrently.

Ordered that judgment be entered herein accordingly in each of said cases.

It is Further Ordered that the Clerk of this Court deliver a certified copy of each judgment and commitment to the United States Marshal or other qualified officer and that the same shall serve as the commitment herein.

The Court recommends commitment to a Jail Type Institution. [17]

District Court of the United States, Northern  
Northern District of California, Southern Division

No. 29633-R

UNITED STATES OF AMERICA

vs.

AMERIGO BELLUOMINI

Criminal Information in Three counts for violation  
of Second War Powers Act, Title III, Section  
301, Public Law 507, 77th Congress; Title 50  
U.S.C.A., App., Section 633.

### JUDGMENT AND COMMITMENT

On this 12th day of October, 1945, came the  
United States Attorney, and the defendant Amerigo  
Belluomini appearing in proper person, and by  
counsel, and,

The defendant having been adjudged guilty by  
the Court of the offenses charged in the Informa-  
tion in the above-entitled cause, to-wit: Viol. Title  
50 USCA App., Section 633. Count One—Defend-  
ant did, on or about May 7, 1945, in San Francisco,  
California, unlawfully possess certain counterfeited  
and forged Red Meat Ration Stamps. Counts Two  
and Three—Defendant did, on or about May 23,  
1945, and May 9, 1945, respectively, in San Fran-  
cisco, California, unlawfully transfer to a certain  
individual and to the Bank of America, 37th Ave.  
& Balboa St. Branch, certain counterfeited and

forged Red Meat Ration Stamps and the defendant having been now asked whether he has anything to say why judgment should not be pronounced against him, and no sufficient cause to the contrary being shown or appearing to the Court, It Is By the Court

Ordered and Adjudged that the defendant, having been found guilty of said offenses, is hereby committed to the custody of the Attorney General or his authorized representative for imprisonment for the period of Six (6) Months on each of Counts One, Two and Three of the Information, and pay a fine to the United States of America in the sum of One Thousand (1,000.00) Dollars on each of Counts One, Two and Three of the Information, making a total fine of Three Thousand (3,000.00) Dollars, and that said defendant be further imprisoned until payment of said fines, or until said defendant is otherwise discharged as provided by law.

It Is Further Ordered that the sentences of imprisonment imposed on defendant in this case on Counts One, Two and Three of the Information commence and run concurrently.

Entered in Vol. 36 Judg. and Decrees at page 394.

It Is Further Ordered that the Clerk deliver a certified copy of this judgment and commitment to the United States Marshal or other qualified officer

and that the same shall serve as the commitment herein.

(Signed) MICHAEL J. ROCHE

United States District Judge

Examined by:

REYNOLD H. COLVIN

Assistant U. S. Attorney

The Court recommends commitment to a Jail Type Institution.

[Endorsed]: Filed and Entered this 12th day of October, 1945. [18]

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District Court of the United States, Northern  
District of California, Southern Division

No. 29635-R

UNITED STATES OF AMERICA

vs.

EDGAR RUGGIERO

Criminal Information in Three counts for violation  
of Second War Powers Act, Title III, Section  
301, Public Law 507, 77th Congress; Title 50  
U.S.C.A., App. Section 633.

### JUDGMENT AND COMMITMENT

On this 12th day of October, 1945, came the United States Attorney, and the defendant Edgar Ruggiero appearing in proper person, and by counsel, adjudged guilty by the Court of the offenses

charged in the Information in the above-entitled cause, to-wit: Viol. Title 50 USCA App., Section 633. Count One—Defendant did, on or about May 7, 1945, in San Francisco, California, unlawfully possess certain counterfeited and forged Red Meat Ration Stamps. Counts Two and Three—Defendant did, on the aforesaid date, in San Francisco, California, unlawfully transfer to a certain individual and to the Bank of America West Portal Branch, certain counterfeited and forged Red Meat Ration Stamps, and the defendant having been now asked whether he has anything to say why judgment should not be pronounced against him, and no sufficient cause to the contrary being shown or appearing to the Court, It Is By the Court

Ordered and Adjudged that the defendant, having been found guilty of said offenses, is hereby committed to the custody of the Attorney General or his authorized representative for imprisonment for the period of Six (6) Months on each of Counts One, Two and Three of the Information, and pay a fine to the United States of America in the sum of One Thousand (1,000.00) Dollars on each of Counts One, Two and Three of the Information, making a total fine of Three Thousand (\$3,000.00) Dollars, and that defendant be further imprisoned until payment of said fines, or until said defendant is otherwise discharged as provided by law.

It Is Further Ordered that the sentences of imprisonment imposed on defendant in this case on Counts One, Two and Three of the Information commence and run concurrently.



Entered in Vol. 36, Judg. and Decrees at page 395.

It Is Further Ordered that the Clerk deliver a certified copy of this judgment and commitment to the United States Marshal or other qualified officer and that the same shall serve as the commitment herein.

(Signed) MICHAEL J. ROCHE

United States District Judge

Examined by:

REYNOLD H. COLVIN

Assistant U. S. Attorney

The Court recommends commitment to a Jail Type Institution.

[Endorsed]: Filed and Entered this 12th day of October, 1945. [19]

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[Title of District Court and Cause—No. 29633-R.]

### NOTICE OF APPEAL

Name and address of Appellant: Amerigo Belluomini, 34 Parsons Street, San Francisco, California.

Name and address of Appellant's attorneys: William E. Ferriter, Esq., 645 Mills Tower, San Francisco, California, and William Petros, Esq., 645 Mills Tower, San Francisco 4, California.

Offense: Violating Second War Powers Act, Title III, Sec. 301, Public Law 507, 77th Congress, Title 50, U.S.C.A. App., Sec. 633.

Date of Judgment: October 12th, 1945. [20]

## BRIEF DESCRIPTION OF JUDGMENT AND SENTENCE

The defendant was adjudged guilty of the above named violation charged in an Information filed by Frank J. Hennessy, United States Attorney for the Northern District of California on July 31, 1945, and sentenced to imprisonment for a period of six months on each of the three counts of said Information, said sentences to run concurrently in the County Jail, and fined the sum of One Thousand Dollars (\$1.000) on each of the three counts of said Information.

Appellant is at liberty on bail deposited with the Clerk of the above entitled Court pursuant to order made on the . . . . day of October, 1945, by the Honorable Michael J. Roche, the trial judge, fixing such bail upon this appeal.

I, the above named appellant, hereby appeal to the United States Circuit Court of Appeals, for the Ninth Circuit, from the judgment above mentioned, on the grounds set forth below:

1. That the evidence adduced upon the trial of said cause was insufficient to warrant the judgment of conviction;

2. That the court lacked jurisdiction to, and did therefore improperly, sentence appellant to both fine and imprisonment upon a conviction of the three counts contained in said Information, in that none of the said counts contained in said Information charges or attempts to charge or purports to charge any violation of the Second War Powers

Act, Title III, section 301, Public Law 507, 77th Congress, Title 50 U.S.C.A App., sec. 633;

3. That, inasmuch as the said information and the three counts contained therein do not charge or purport to charge a violation of the Second War Powers Act, the judgment and conviction herein imposed is void; [21]

4. That the said Information and the three counts therein contained charge and purport to charge a violation of section 2.6 of General Ration Order No. 8; and that, inasmuch as said conviction and the sentences imposed herein are based upon said violation, said conviction and sentences are void, and each of said sentences is void.

5. That the learned trial judge committed errors in law arising during the course of the trial, and erred in the decision of questions of law arising during the course of said trial;

6. That the evidence adduced and received upon the trial of said cause was insufficient as a matter of law to justify the judgment of the trial court;

7. That the learned trial judge erred in denying the motion to dismiss at the conclusion of the case of the prosecution, for the reason that taking said evidence in said cause was not sufficient as a matter of law to support the judgment of "Guilty";

8. That this honorable court has no jurisdiction of the above entitled cause or to hear or determine the said Information, or to try this defendant thereon or as to any count thereof, for the reason that General Ration Order 8 is unconstitutional and void, and that no criminal prosecution will lie for

any alleged violation of any of the provisions of said order, for the reason that section 3.1 of Article III of said General Ration Order purports and attempts to punish the violation of the said order or any other ration order as a crime and fixes the penalty therefor; and that the Price Administrator has no power to declare what acts shall be criminal or shall constitute crimes, or to determine the punishments for any act; that no statute of the United States, and no act of Congress, confers upon the Price Administrator [22] the power to define or to punish crimes, and that if any act of Congress can be construed as an authorization to said Price Administrator to define and punish crimes, or to declare that any act shall constitute a crime and fix the punishment therefor, such Act is to that extent unconstitutional and void, and in violation of the provision of the Fifth Amendment to the Constitution of the United States that no person shall be deprived of life, liberty or property without due process of law, and is an unlawful delegation of legislative powers which are vested by the constitution of the United States in the Congress alone.

Dated: October 12, 1945.

AMERIGO BELLUOMINI

Appellant

WM. E. FERRITER

WM. PETROS

Attorneys for Appellant

[Endorsed]: Filed Oct. 12, 1945. [23]

[Title of District Court and Cause—No. 29635-R.]

## NOTICE OF APPEAL

Name and Address of Appellant: Edgar Ruggiero.  
San Francisco, California.

Name and Address of Appellant's Attorney: Walter H. Duane, Esq., 790 Mills Building, San Francisco 4, California.

Offense: Violating Second War Powers Act, Title III, sec. 301, Public Law 507, 77th Congress, Title 50, U.S.C.A. App., sec. 633.

Date of Judgment: October 12th, 1945. [24]

## BRIEF DESCRIPTION OF JUDGMENT AND SENTENCE

The defendant was adjudged guilty of the above named violation charged in an Information filed by Frank J. Hennessy, United States Attorney for the Northern District of California, on July 31, 1945, and sentenced to imprisonment for a period of six months on each of the three counts of said Information, said sentences to run concurrently in the County Jail, and fined the sum of One Thousand Dollars (\$1,000) on each of the three counts of said Information.

Appellant is at liberty on bail deposited with the Clerk of the above entitled Court pursuant to order made on the 13th day of October, 1945 by the Honorable Michael J. Roche, the trial judge, fixing such bail upon this appeal.

I, the above named appellant, hereby appeal to the United States Circuit Court of Appeals, for the Ninth Circuit, from the judgment above mentioned, on the grounds set forth below:

1. That the evidence adduced upon the trial of said cause was insufficient to warrant the judgment of conviction;

2. That the court lacked jurisdiction to, and did therefore improperly, sentence appellant to both fine and imprisonment upon a conviction of the three counts contained in said Information, in that none of the said counts contained charges or attempts to charge or purports to charge any violation of the Second War Powers Act, Title III, section 301, Public Law 507, 77th Congress, Title 50 U.S.C.A. App., sec. 633;

3. That, inasmuch as the said information and the three counts contained therein do not charge or purport to charge a violation of the Second War Powers Act, the judgment and conviction herein imposed is void;

4. That the said Information and the three counts therein contained charge and purport to charge a violation of [25] section 2.6 of General Ration Order No. 8; and that, inasmuch as said conviction and the sentences imposed herein are based upon said violation, said conviction and sentences are void, and each of said sentences is void;

5. That the learned trial judge committed errors in law arising during the course of the trial, and erred in the decision of questions of law arising during the course of said trial;

6. That the evidence adduced and received upon the trial of said cause was insufficient as a matter of law to justify the judgment of the trial court;

7. That the learned trial judge erred in denying the motion to dismiss at the conclusion of the case of the prosecution, for the reason that taking said evidence in said cause was not sufficient as a matter of law to support the judgment of "Guilty";

8. That this honorable court has no jurisdiction of the above entitled cause or to hear or determine the said Information or to try this defendant thereon or as to any count thereof, for the reason that General Ration Order 8 is unconstitutional and void, and that no criminal prosecution will lie for any alleged violation of any of the provisions of said order, for the reason that section 3.1 of Article III of said General Ration Order purports and attempts to punish the violation of said order or any other ration order as a crime and fixes the penalty therefor; and the Price Administrator has no power to declare what acts shall be criminal or shall constitute crimes, or to determine the punishments for any act; that no statute of the United States, and no act of Congress, confers upon the Price Administrator the power to define or to punish crimes, and that if any act of Congress can be construed as an authorization to said Price Administrator to define and punish crimes, or to declare that any act shall constitute a crime and fix the [26] punishment therefor, such Act is to that extent unconstitutional and void,

and in violation of the provisions of the Fifth Amendment to the Constitution of the United States that no person shall be deprived of life, liberty or property without due process of law, and is an unlawful delegation of legislative powers which are vested by the constitution of the United States in the Congress alone.

Dated: October 12, 1945.

EDGAR RUGGIERO

Appellant.

WALTER H. DUANE

Attorney for Appellant.

[Endorsed]: Filed Oct. 13, 1945. [27]

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[Title of District Court and Cause—No. 29633-R.]  
ASSIGNMENT OF ERRORS OF DEFENDANT  
AMERIGO BELLUOMINI

Now Comes the Defendant, Amerigo Belluomini, who heretofore has appealed to the United States Circuit Court of Appeals for the Ninth Circuit from the judgment and sentence heretofore given, made and entered against said defendant in the above entitled cause, and files this, his assignment of the errors on which he will rely in the prosecution of the said appeal: [28]

1. That the said District Court erred in overruling the Demurrer of this defendant to the Information in the above entitled cause;



2. That the said Information does not, nor does any of the several counts thereof, charge this defendant with any crime or offense against the United States of America, and that said District Court accordingly had no jurisdiction to hear or determine the same, or to render judgment or pass sentence upon this defendant;

3. That the evidence taken and had upon the trial of the said cause was and is insufficient to justify the verdict or order of the court finding this defendant guilty on the said Information, or on any of the several counts thereof;

4. That said District Court erred in denying the motion of defendants to dismiss;

5. That said District Court erred in ruling that the evidence was sufficient to justify a conviction upon all or any of the counts in the said Information.

Wherefore, said defendant, Amerigo Belluomini, prays that the judgment and sentence aforesaid be reversed, and that the said defendant go hence, without day.

(Signed) WM. E. FERRITER,  
Attorney for defendant,  
Amerigo Belluomini.

Service Acknowledged October 25, 1945.

FRANK J. HENNESSY

United States Attorney for the Northern District  
of California.

[Endorsed]: Filed Oct. 25, 1945. [29]

[Title of District Court and Cause—No. 29635-R]  
ASSIGNMENT OF ERRORS OF DEFENDANT  
EDGAR RUGGIERO

Now Comes the Defendant, Edgar Ruggiero, who heretofore has appealed to the United States Circuit Court of Appeals for the Ninth Circuit from the judgment and sentence heretofore given, made and entered against said defendant in the above entitled cause, and files this, his assignment of the errors on which he will rely in the prosecution of the said appeal; [30]

1. That the said Information does not, nor does any of the several counts thereof, charge this defendant with any crime or offense against the United States of America, and that said District Court accordingly had no jurisdiction to hear or determine the same, or to render judgment or pass sentence upon this defendant;

2. That the evidence taken and had upon the trial of the said cause was and is insufficient to justify the verdict or order of the court finding this defendant guilty on the said Information, or on any of the several counts thereof;

3. That said District Court erred in denying the motion of defendants to dismiss;

4. That said District Court erred in ruling that the evidence was sufficient to justify a conviction upon all or any of the counts in the said Information.

Wherefore, said defendant, Edgar Ruggiero,

prays that the judgment and sentence aforesaid be reversed, and that the said defendant go hence, without day.

WALTER H. DUANE,  
Attorney for Defendant  
Edgar Ruggiero.

Service Acknowledged October 25, 1945.

FRANK J. HENNESSY

United States Attorney for the Northern District  
of California.

[Endorsed]: Filed Oct. 25, 1945. [31]

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[Title of Court and Cause—Nos. 29633, 29635.]

### BILL OF EXCEPTIONS

To Be Used on the Appeals of Defendants to the  
United States Circuit Court of Appeals for the  
Ninth Circuit. [32]

Now Come Amerigo Belluomini and Edgar Ruggiero, the Defendants in the causes numbered and entitled as above, which said causes were, by order of the said District Court, pursuant to stipulation of counsel for each of the said defendants, consolidated for the purpose of trial, and present this, their Bill of Exceptions to be used upon their several appeals to the United States Circuit Court of Appeals for the Ninth Circuit from the judgments and sentences severally given, made and entered against said defendants in and by the said United States District Court:

Be It Remembered that the said causes or ac-

tions came on regularly for trial the 9th day of October, 1945, before Honorable Michael J. Roche, United States District Judge in and for the district aforesaid, without a jury, a trial by jury having been theretofore waived in each of the said causes, by each of the said defendants, and by the United States of America by and through the United States Attorney for the District aforesaid, with the approval and consent of the said District Court.

Thereupon counsel for the defendants in each cause and the United States Attorney stipulated, and the court thereupon ordered, that the said causes be consolidated for the purpose of trial.

Thereupon the following proceedings, and none other, were taken and had, and the following evidence, and none other, was introduced and received. [33]

Thereupon the United States Attorney made the following Opening Statement on behalf of the Government:

May it please the Court, in this matter the defendants Belluomini and Ruggiero are charged with possessing and transferring certain counterfeited and forged ration documents under circumstances which were in violation of the ration laws.

The events in these cases took place in May of this year. The defendant Ruggiero, as the record will show, is engaged in the management of a market called the Tunnel Market at 174 West Portal

Avenue in San Francisco, California. We will show by the defendants' admissions that the defendant Ruggiero did purchase a large quantity of red meat stamps, that is, ration stamps, which could be used for the purchase or transferred as currency for meat. Ruggiero had for a business associate the other defendant in this matter, one Amerigo Belluomini, who has a market at 3601 Balboa Street. Ruggiero transferred certain stamps to Belluomini. This was thoroughly a commercial transaction. We shall show these were stamps which were never properly transferable in the course of ration business. The Government's first witness will be Mr. Slade.

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### E. W. SLADE

called as a witness on behalf of the Government, and having been first duly sworn to tell the truth, the whole truth, and nothing but the truth, testified as follows:

I have charge of the Regional Verification Center of the Office of Price Administration, 1267 Mission Street, San Francisco. The function of the Verification Center is to [34] examine all ration currencies deposited in the bank after the public has used them. These examinations are done in my presence and under my supervision. I was so employed during the month of May, 1945. I have been in the Verification Center since its inception in the Spring of 1944. I saw Government's Exhibits 1-A to 1-H, inclusive, for Identification, on May 22,

(Testimony of E. W. Slade.)

1945. These envelopes were brought to me after they had been opened and the contents found to be counterfeits. I was asked to verify the counterfeit nature of the evidence. After a conference I typed the counterfeits CFM-4. These envelopes contained 500 counterfeits each, except the last one. There are 7 envelopes, each of which contained 500 counterfeits, and the last one contained 280 counterfeit stamps. The last one, to which I have just referred, was Government's Exhibit 1-B for Identification. After examining the envelopes and the contents, I typed the counterfeits; they were noted in the upper right hand of the envelope, I initialed the envelopes and the date of examination, and then I returned the evidence to the Special Agent of the Office of Price Administration, Mr. Reimel. I designated these envelopes by the code number, which was CFM-4. The stamps contained in those envelopes were not of a nature which could at any time be transferred as ration coupons. As soon as we discovered the evidence, I telephoned Mr. Reimel, who came over to the Verification Center. I handed the evidence over to him May 22. The five envelopes now shown me, which are marked Government's Exhibits for Identification 2-A to 2-E, inclusive, were brought to me by Mr. Reimel. I was asked to examine the contents of these envelopes and having done so I made a notation on the face of each, "Checked May 25, 1945." So I assume that was the date on which I examined those envelopes. Mr. Reimel was present. I examined these five envelopes

(Testimony of E. W. Slade.)

and found that each of them contained 500 counterfeit ration stamps of [35] the same type as we have previously found in the other matter. When counterfeits are found, they are classified as to type. During May we came across about 5 different types of counterfeits in this region. These types are assigned by the national office in Washington. When we run across a new counterfeit, we obtain the type number which has been already assigned to it, or, if a new counterfeit, a new number is assigned to it by the national office in Washington. The coupons contained in the envelopes marked "2-A" to "2-E" for Identification, inclusive, were the same type as the coupons contained in the envelopes marked Government's Exhibits "1-A" to "1-H," inclusive. That type of coupons we never issue for valid use under the rationing regulations. Each envelope contains 500 counterfeits. I found no genuine coupons in either Government's Exhibits 1-A to 1-H inclusive, or in Government's Exhibit 2-A to 2-E, inclusive.

### Cross-Examination

By Mr. Duane:

We examine ration currencies after they have been used by the public. We put them through three examinations. This is not a spot check. It is a 100% check. They use certain chemical processes for that purpose. That is one of the tests. From the data before me, I identify them as counterfeits.

(Testimony of E. W. Slade.)

By Mr. Ferriter:

That is the usual course of practice, only when we have already found counterfeits. We then merely suggested that the deposits in that bank be examined, and we wait for them to come to the Verification Center. It is the customary practice when we find evidence of that kind. [36]

#### Re-Direct Examination

By Mr. Colvin:

We have a visual examination, and we have certain laboratory tests. The visual examination will show,—there are certain things, such as, for instance, the number of perforations around the edge of a stamp. These perforations are too frequent in the counterfeits. I refer particularly to the vertical perforations. There are about 17 in the counterfeit stamps. There should be only 12. All the stamps issued by the Government for Region 8 contained 3 little dots circled in the cornucopia. These counterfeits are only dotted on the upper circle. The paper, of course, is spurious. It is negative to all safety devices, which the Government placed in its own paper. The Government paper is a fluorescent water mark which fluoresces under the ultra-violet light. This stamp is dead under the ultra-violet light. The Government paper has a design printed on the reverse, which comes out with the application of a certain chemical. On applying that chemical to these counterfeits, there is no such



(Testimony of E. W. Slade.)

pattern that comes out. The process design, which is a designed background on these stamps, contains several errors in the counterfeit. In the genuine stamp, the eagles are printed diagonally; in the counterfeits the eagles are printed straight up and down. The shield in the counterfeit contains four lines. It should contain only three. The printing process is a typographical one, instead of being a letter process. The printing job is more readily done than in the genuine stamps. Aside from the chemical tests, there are certain physical tests by which the human eye can distinguish these coupons from the genuine [37] coupons, which are called visual tests.

After examining Government's Exhibits 2-A to 2-E, inclusive, I returned these envelopes to Mr. Reimel.

(To the Court:) Before I went there, I was in charge of the British Import and Export house or branch in China and Japan. I was in the Kobe, Yokohama and Nagoya branches.

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### JAMES REIMEL

called as a witness on behalf of the Government, and being first duly sworn, testified:

I am special assistant to the legislative auditor for the State of California. I was employed by the Office of Price Administration up until September 1st of this year, as special agent in charge of the San Francisco office Office of Currency Protection,

(Testimony of James Reimel.)

and was so employed during the month of May, 1945. I have seen these envelopes marked "Government's for Identification" numbers 1-A to 1-H, inclusive. These envelopes were handed to me by Mr. Slade at 2:00 p.m. on May 22, 1945, as I recall it. I put my initials on them. I then took them with me and called on the Tunnel Meat Market, West Portal Avenue, San Francisco. I talked to the Manager of that place, Mr. Edgar Ruggiero. I see Mr. Ruggiero in the courtroom, seated immediately behind Mr. Duane. I showed him the envelopes and contents. I believe I opened the envelopes at that time. I had a conversation with Mr. Ruggiero with reference to the contents of the envelopes. Mr. Ruggiero and myself talked for approximately an hour concerning these stamps. There were other employees in Mr. Ruggiero's meat market, but I doubt if any of them were present and heard the conversation. That conversation took place on the same day I had first received the envelopes, the [38] 22d of May, 1945. I inquired of Mr. Ruggiero if he had any knowledge of the source of the stamps.

Mr. Ferriter: It will be agreed, I take it, this conversation is not binding upon the defendant Belluomini.

The Court: Not unless it is connected up.

The Witness: (continuing) He stated at that time he did not have any knowledge of the source of these particular stamps. I explained to him that they were counterfeit. He agreed that they had been placed by him in the West Portal branch of the

(Testimony of James Reimel.)

Bank of America. During the conversation he stated that he was not the owner of the market, but was under the direction of a Mr. Belluomini, the owner. After talking with him for some time, I found nothing concerning where he got the stamps. He did not recall it, except to say that he got them through the manager of his place of business at that time. The conversation ended, I should say, about 4:30 or 5:00 o'clock. I kept these envelopes in my possession. I had a conversation with Mr. Ruggiero later that day, at approximately 7:30 p.m., May 22, 1945. During part of that conversation Mr. Amerigo Belluomini was present at his place of business. I see Mr. Belluomini here in court: the second gentleman on the far side of the table.

[Counsel for the defendant stipulated that the witness identified the said defendant.]

After leaving Mr. Ruggiero's place of business, I waited outside the shop until about 6:00 p.m., then I went to the place of business operated by Mr. Belluomini at 3601 Balboa Boulevard in San Francisco. I drove up on the outside. I could see Mr. Ruggiero and Mr. Belluomini carrying on a conversation inside the place. After waiting a few minutes, I walked in and spoke to Mr. Ruggiero. [39]

He said he had some more to tell me about the stamps. We stepped outside the shop. I sat in the car which I had been driving, and at that time Mr. Ruggiero stated that he could tell me now where he got the stamps. He stated that on or about

(Testimony of James Reimel.)

May 5 a person came into the shop, the shop he was managing, the Tunnel Market, and bought some meat. This person came in a few times later, maybe two or three times later and made a habit of talking with Ruggiero. Finally he stated he wanted some steak, was willing to pay any price but was short of stamps and would Ruggiero let him have enough points. Mr. Ruggiero said no, that he was up against it for points himself and with that the stranger stated that he could supply Mr. Ruggiero with some points at a later date if he would be interested. According to Mr. Ruggiero, he stated, "Well, what butcher wouldn't be interested in getting more stamps!" So a few days after that this individual called Mr. Ruggiero by telephone, stated he now had 8,700 stamps which he would be willing to sell to Mr. Ruggiero for a price of \$1,820 cash. Mr. Ruggiero said that previous to this telephone conversation he had talked the matter over with Mr. Belluomini. Mr. Belluomini was agreeable to take some stamps, although he didn't want as many as he finally got, according to both he and Ruggiero. After the telephone conversation Ruggiero went to the bank, West Portal Branch, there cashed a check for \$1,820 to get the cash to pay off this seller of the counterfeit stamps. Ruggiero after getting the cash returned to the shop. A few minutes later the gentleman came in and left him 8,700 stamps, 87,000 points, which were each worth 10 points. After he received the stamps he turned 5,000 stamps over to Mr. Belluomini and

(Testimony of James Reimel.)

the other 3,700-3,800 he deposited in the West Portal branch of the Bank of America. On or about May 19 they were sent by that bank to the verification center where Mr. Slade on the 22d of [40] May discovered them and called our office. I have seen Government's for Identification numbers 2-A to 2-E inclusive, consisting of 5 envelopes. I acquired these envelopes containing stamps from the Bank of America in the 3700 block of Balboa Street in San Francisco, from the assistant cashier, whose name appears on the back of the envelope. Mr. Amerigo Belluomini was present at that time. On the evening of May 22, after I had talked with Mr. Ruggiero, Mr. Belluomini was brought into the conversation a little later, and stated that he had deposited some of the stamps which he got from Mr. Ruggiero in the bank on Balboa Street. At that time it was agreed that on the following morning I would call on Mr. Belluomini and he and I together would go to the Bank of America and there check to see if these stamps still were there. He had a record showing that he had deposited 25,000 points at the Bank of America on May 9. Twenty-five thousand points would be 2,500 stamps. On the following morning, Mr. Belluomini and myself went down to the bank and talked to the assistant manager in charge of the bank, who permitted us to go in and look at the deposit made by Mr. Belluomini. We examined the envelopes. Most of them I slit open in the presence of the cashier and Mr. Belluomini, and examined the stamps. Out of

(Testimony of James Reimel.)

his deposit we located these five envelopes. Mr. Belluomini placed his signature at the top and bottom of each one the day we acquired them from the bank. I had a conversation, which I have not yet related, with the defendant Belluomini, on May 23. I asked Mr. Belluomini what had happened to the balance of the stamps. He told me he had acquired 5,000 and Mr. Ruggiero said he had turned over 5,000 stamps, yet we only found 2,500 in the bank depositary. He then related that one of his friends who occasionally worked for him, kept his books, and made deposits at the bank for him, whose name is Leo Messaglia, had been in the butcher shop on the same evening that I was there, May 22, just previous to my getting there, and at that time Mr. Belluomini and Mr. Ruggiero had talked the matter over. They knew they had bad stamps. They advised Mr. Messaglia to destroy the balance which he was supposed to have in his home. Mr. Messaglia lives over in Fairfax. According to Mr. Messaglia, he went home that night and placed the 2,500 stamps, counterfeit stamps, in his stove and burned them up because he was advised that I would want to see him. On the evening of May 22, Mr. Messaglia, Mr. Belluomini and Mr. Ruggiero were in my office at 1355 Market Street, and there reduced their information and statements to affidavit form. They accompanied me willingly. Three of the persons named, and I believe Miss Paige, my stenographer, were present during the conversation. I don't recall any other person present at that

(Testimony of James Reimel.)

time; there may have been. That statement may have been made May 23d, I am not exact about that. It was either the day I first talked with Ruggiero or the following day. I advised them that the statement was to be given voluntarily, and they were not threatened or promised, nor were they told they would escape prosecution at any time. I advised them of my official position.

Thereupon the statement of Edgar Ruggiero was marked "Government's Exhibit 3 for Identification."

The Witness: United States Exhibit 3 for Identification, which bears a signature in writing, "Edgar Ruggiero," is the statement of Mr. Ruggiero to which I have referred.

Thereupon the witness read to the court the said exhibit, which is in the words and figures following to-wit: [42]

"I, Edgar Ruggiero, do hereby report and state to Mr. J. O. Reimel, an agent for the Office of Price Administration, the following facts:

"This statement has been given of my own free will, I have received no promises or been threatened in any way. I state that I am 30 years of age and reside at 1435 22nd Avenue, San Francisco, California. I am married and have two minor children. I am employed as manager of the Tunnel Meat Market, 174 West Portal Avenue, West San Francisco, California.

"On or about May 5, 1945, I was approached by

(Testimony of James Reimel.)

one of my customers, a man whose name I do not know, or whose residence I do not know, who asked me if I needed meat points. I told him I could use them so he said someday he might bring me in some. He brought in a large brown manila envelope containing approximately 87,000 red meat points. I did not check the number of coupons at that time but took his word for the fact that there were that amount of points in the envelope. The man who brought the stamps in to me quoted me a price of \$1,820 cash or twenty cents per coupon. I became acquainted in the following manner: He came into the market and purchased meat from me numerous times before he brought up the question of me wanting points, and each time he made a purchase he paid cash for the meat and gave me the exact number of points. Then after he had been in a number of times, he wanted a roast and some steaks. He said he didn't care about the price but he did not have any points. I told him it was impossible to give him any meat without points and he seemed curious and wanted to know why. I explained to him that we needed points when we purchased our meat and that if we sold meat [43] without points we wouldn't have any points left to buy any meat. That was when he asked me if I could use some points and at that particular time I could. We had just had a robbery and I had lost 29,810 points which the Office of Price Administration denied to refund. After I had purchased these stamps



(Testimony of James Reimel.)

a check came from the Office of Price Administration for 29,810 points.

“My conversation with the man who sold me the stamps were each time very brief. He just came in and out like any other customer and I never learned his place of residence or his name or his place of business. I can best describe him as about 5' 7" in height, weight 150 pounds, dark complected, wore a hat over his eyes, wore dark glasses and sport clothing. One of the outstanding features that impressed me was the thinness of his face and high cheek bones. His clothing looked to me as if it were expensive, and the shirt which he wore, blue in color, might have been hand tailored. It is my opinion I would be able to identify the individual if I were to see him again, but since the day he sold me the stamps he has not made an appearance at the Tunnel Market.

“On the day that I bought the stamps the following arrangements were made: I was called by this individual over my telephone at the market and he asked me if I still wanted the meat stamps and stated he wanted cash for them. He then quoted the price to me and said he would be out in about one-half hour. I then drew a check for \$1820, made it out to myself, and went to the Bank of America and there obtained that amount of cash and returned to my place of business. Soon after I returned to my place of [44] business the individual came in carrying the above envelope containing the coupons. I opened this envelope to ascertain the

(Testimony of James Reimel.)

contents, I gave him the money and then he departed.

“Before I definitely made arrangements to take the coupons from the man, I called the owner of the market, Mr. Amerigo Belluomini, owner and operator of the 37th and Balboa Market, and asked him if he still wanted some meat stamps. He said yes that he did. It was my opinion that Mr. Belluomini was to take one-half of the stamps. After having obtained the stamps I took them home and my wife counted part of them and I counted the rest. My wife does not know the source of the stamps. It is an ordinary thing for me to take my stamps home and have her count them. After I had the stamps counted, I brought 50,000 points to Amerigo Belluomini in ten small envelopes of 500 stamps each. I collected from Mr. Belluomini a sum of \$1000.00 at a later period. The other 37,800 I deposited to my ration bank account at the Bank of America, West Portal Branch.

“Subsequently I gave the Office of Price Administration representative a check for 37,800 points to take care of the stamps that were placed in my account.

“I have since been advised that the stamps which I bought from this unknown person were counterfeit. At the time I bought them I didn't really stop to consider the source of the stamps. On the evening of Tuesday, May 22, 1945, at about 6:30 p.m., I was engaged in a conversation with Mr. Belluomini and Leo Messaglia at the 37th and Bal-

(Testimony of James Reimel.)

boa Market, and during [45] the conversation we were discussing what to do with the remainder of the meat points which I transferred to Belluomini, as I learned that Belluomini has not used all of them and I am not familiar with how many he had not used. We thought the best way to confiscate that portion which Belluomini had not used was burning them.

"I have given the above statement of my own free will and I know of no additional facts at this time which will change or add to the statement. I have read and am thoroughly familiar with the contents.

**"EDGAR RUGGIERO**

"Witness: Amerigo Belluomini.

"Subscribed and sworn to before this 23rd day of May, 1945.

**"J. O. REIMEL**

Investigator, Office of Price  
Administration."

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The Witness: (Continuing) The document now shown me, marked Government's Exhibit No. 4 for Identification, which is entitled, "Office of Price Administration,—Statement," and bears the signature of A. Belluomini, is one of the written statements taken at the conversation to which I have already referred.

Thereupon the witness read to the Court the said

(Testimony of James Reimel.)

statement, which is in the words and figures following, to-wit:

“I, Amerigo Belluomini, do hereby report and state to Mr. J. O. Reimel, an agent for the Office of Price Administration, the following facts:

“This statement has been given of my own free will, I have received no promises or been threatened in [46] any way. I state that I am 52 years of age and own and operate the 37th and Balboa Market at 3601 Balboa Street in San Francisco. I also own the Tunnel Market at 174 West Portal Avenue, San Francisco, California.

“On or about May 5, 1945, I received a telephone call from one of my employees, Edgar Ruggiero, who manages the Tunnel Market, and Ed asked me if I was interested in obtaining some meat stamps and I told him I was. He told me that he had an opportunity to obtain 86,000 points but I did not want that many and remarked that I would take one-half. I did not mean that I would take one-half of 86,000, but I meant that Ed should take only 43,000 and that I would take one-half of the 43,000. A couple of days after this telephone conversation, Edgar Ruggiero brought to my place of business on Balboa Street ten envelopes each containing 500 red meat stamps. I did not open the envelopes but assumed each envelope contained meat stamps. These envelopes were later turned over to Leo Messaglia who usually prepares my ration currency deposit slips. I believe Leo prepared five envelopes each containing 500 points of the above

(Testimony of James Reimel.)

mentioned stamps for deposit and they were deposited to my ration bank account on May 9, 1945, at the Bank of America, 3701 Balboa Street in San Francisco.

“On May 23, 1945, I accompanied Mr. Reimel to the Bank of America and there examined the deposits made by my place of business and was shown five of the envelopes which I had deposited and it was explained to me by Mr. Reimel that each of these five envelopes contained counterfeit coupons. I have placed my initial on the back of each envelope.

“On May 22, 1945, at about 6:30 p.m., I was engaged in [47] “conversation with Mr. Ruggiero and Geo. Messaglia, and among ourselves it was thought the best policy to destroy the balance of coupons which I had obtained from Ruggiero. As I obtained approximately 50,000 of the points and had used 25,000 of the points, it is my opinion that I still had 25,000 points left, these being in the custody of Leo Messaglia. It was thought best to burn them and according to my belief, Leo went home and burned them either on Tuesday evening, May 22, 1945, or early Wednesday morning, May 23, 1945. At no time did I ever have occasion to become acquainted with the man who sold Ed the stamps, and I do not know his identity. Further, I never knew the stamps which I obtained from Edgar Ruggiero were counterfeit.

“I have given the above statement of my own free will and I know of no additional facts at this

(Testimony of James Reimel.)

time which will change or add to the statement. I have read and am thoroughly familiar with the contents.”

The Witness: (continuing) This statement is signed by Mr. Belluomini and witnessed by Mr. Ruggiero.

These envelopes, marked “Government’s Exhibits 1-A to 1-H, inclusive, were returned to our office. I have a steel cabinet there and have the key. I kept these envelopes locked in that cabinet until they were submitted to the United States Attorney’s Office. As far as the physical condition of the envelopes is concerned, they are now in the same condition as they were when I delivered them to the United States Attorney’s Office.

The envelopes marked “Government’s for Identification 2-A to 2-E” were not shown to the defendant Ruggiero. Mr. Belluomini has seen them. But after having had Mr. Slade of the verification [48] center verify they were counterfeits, they were taken to our office and locked in the steel cabinet until they were turned over to the United States Attorney with the report, and they are now in the same physical condition that they were when I turned them over to the United States Attorney.

### Cross Examination

By Mr. Duane:

I first saw the defendant Ruggiero on May 22 in the late afternoon. It was the following day that I took the statement. I had some conversation with,

(Testimony of James Reimel.)

him on the 22d. Somewhat along the lines of the statement. I did not check on the matter of the check that he cashed for \$1820 or on the statement that the establishment was burglarized. He told me, however, that the place had been robbed and about 29,000-odd points were stolen. He gave me a check to the best of my memory, for 37,800 points, to make good the points that had gone into the bank. His statements to me were all freely and voluntarily given. There was no promise or anything of that kind in connection with the statements whatsoever. I would say that he cooperated as far as he could.

#### Cross Examination

By Mr. Ferriter:

I first met Mr. Belluomini on the evening of May 22, 1945. I conversed with him at that time. I saw Mr. Belluomini and his employee, Mr. Ruggiero, in the market at 37th and Balboa. I walked into the place, and I saw them standing at the counter. At that time Mr. Ruggiero told me there was [49] something additional he could tell me. I believe he explained to me on that evening he had deposited his stamps at the Bank of America. Up to that time I did not know Mr. Belluomini's activities or complicity in the matter. He volunteered that himself.

Thereupon Government's Exhibits for Identification Nos. 1-A to 1-H, inclusive, were admitted in evidence as Government's Exhibits 1-A to 1-H inclusive, as to the Defendant Ruggiero;

Government's Exhibits for Identification Numbers 2-A to 2-E, inclusive, were admitted in evidence as Nos. 2-A to 2-E, as to the defendant Belluomini.

The exhibits were marked accordingly.

Government's Exhibit for Identification 3 was admitted as Government's Exhibit No. 3 in evidence, as to the defendant Ruggiero; the exhibit was so marked;

Government's Exhibit 4 for Identification was admitted as Government's Exhibit No. 4 in evidence, as to the defendant Belluomini, and was marked accordingly.

Thereupon counsel for the defendants moved for a dismissal of the charges upon the ground that the Government had not met the burden of proving the wilfulness of the acts complained of, and the said motion was urged by respective counsel and was denied by the Court.

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### EDGAR RUGGIERO

one of the defendants, called as a witness in his own behalf, and having first been duly sworn, testified:

I am 30 years of age, am a married man with two children and am a butcher by occupation. In April and May of this year I was manager of the Tunnel Market. During the month of April of this year the Tunnel Market was burglarized. We lost almost 30,000 points. I reported that burglary to



(Testimony of Edgar Ruggiero.)

the Office of Price Administration and made application to the Office of Price Administration for stamps in place of those that had been [50] stolen. They denied the application. I filed an appeal on a special form for that. The application was finally granted and the points were mailed to me some time in May of 1945. The document now shown to me is a card stating that my petition for replacement of meat and fats ration points is approved, and bears the printed signature, "War Price and Ration Board," and, in ink, "EEK Food Panel."

(The said document was admitted in evidence as Defendant Ruggiero's "Exhibit A.")

I got my stamps previous to the time I got that card. Some time early in May I had some ration stamps, but not enough to operate with. On the occasion I had the conversation with the man that I referred to in my statement, I had very few stamps on hand. I may have been overdrawn in the bank at that time, I don't know exactly how the checks were that were outstanding. I was pretty close to being overdrawn. Maybe I had a thousand on deposit. I don't know how close I was. I received those stamps from the ration board as a replacement. I purchased those stamps from this man and paid him \$1820 for it. I drew a check payable to myself and went to the bank with that check and cashed it, and paid this man for the stamps. I gave some 50,000 points to Mr. Belluomini. I did not know at the time I purchased these stamps that they were counterfeited stamps. I made good

(Testimony of Edgar Ruggiero.)

some 37,800 points to the bank. I made the check payable to the Office of Price Administration, and they deducted from my account. I have never been in any difficulty before.

### Cross Examination

By Mr. Colvin:

At the time I got the stamps I had no conversation with the man from whom I purchased them. He just came in, I [51] gave him the money, and he gave me the stamps, and he left. The stamps were in a large brown manila envelope. I opened the envelope at that time and looked at the stamps. I did not ask any questions at all. I just looked at them, gave him the money and he went right out. I picked up a handful. I put my hand down and picked up the envelope to see if there were stamps in there. I had no conversation with the man regarding his source of the stamps. He didn't say anything at all except previous, when he came in to the store, he didn't say anything at all, he just came in and went out. I gave him the \$1,820, and he went out. I didn't count them then; there were too many stamps to count. That same night they were put in envelopes by my wife and myself, each envelope containing 500 stamps.

### Re-Direct Examination

By Mr. Duane:

I had seen the man several times in my shop. He had been making purchases a few times. He

(Testimony of Edgar Ruggiero.)

had paid stamps and money for his purchases. I have related in this statement that on some occasions he came in there and he wanted some meat and said he had no stamps. I told him I could not serve him because we had been so awfully short of stamps right then. On that occasion, he did not get any meat from me.

### Re-Cross Examination

By Mr. Colvin:

At no time in these earlier conversations did he tell me what kind of stamps he was going to sell me or what the numbers would be. Referring to Government's No. 2-E, a patch of four stamps, I couldn't really remember how many stamps there were in each patch. I just counted them out. They [52] all looked alike. They were in uniform patches. I don't know about the lettering. I can't remember whether they were creased in any way. They all looked in pretty good condition. I don't think any of them showed any signs of having been used before. I couldn't tell you whether they appeared to be newly printed stamps. I didn't think of it, as far as being newly printed. I didn't think of the stamps at all. I mean I just had them on the counter and I deposited them. I thought they were all right.

## AMERIGO BELLUOMINI

one of the defendants, called as a witness in his own behalf, and having been first duly sworn, testified as follows:

“I am 53 years of age, a veteran of the last World War, and a married man. I admit I got 50,000 of these points from my employee Mr. Ruggiero. The matters and things that Mr. Ruggiero testified to I also admit, as well as my statement, which has been read to the court here. I did not have any knowledge whatsoever of the counterfeit or false nature of these stamps. I recall meeting my employee, a Leo Messaglia, in my butcher shop and market on Balboa Street on the evening of May 22. That is the first time I met Mr. Reimel. I never [had] seen Mr. Reimel before. He was standing outside. Mr. Reimel afterward came in. I know that conversation with Mr. Ruggiero while he was outside. Before the meeting Mr. Ruggiero told me the stamps were not good. I did not know that. I went outside and met Mr. Reimel at the car. At that time I told him I also had some stamps. He did not accuse me of having any stamps. I voluntarily told him. I also had some of the stamps. I told him that I deposited some of them, 25,000. Subsequently I took him myself to the bank to get those stamps. [53] I run this particular butcher shop at 37th and Balboa. I have been engaged in the meat business pretty near 40 years. I sell a great deal of meat. I have not been able to sell as much meat during this war as I did prior to the war. I would have sold a lot more if I would have got it, but

(Testimony of Amerigo Belluomini.)

I was not getting very much meat. The operation of my business caused me to lose stamp values. Waste the meat; you can't control all the men. We have four or five butchers. There was a constant loss of points. In my business I was forced to lose points by the manner in which I bought meat. That is one of the reasons why I wanted these stamps. I wanted to stay in business.

### Cross Examination

By Mr. Colvin:

The patch of 4 stamps appearing on the outside of the envelope (Government's Exhibits 2-A to 2-E inclusive) I never handled. I never even seen them. I just took them and turned them over to Messaglia. I never seen them. I never opened the envelope or seen them. It is my testimony that I never opened the envelope. There were no stamps attached to the outside of the envelopes when I received them. They were closed. Mr. Ruggiero did not tell me anything about these stamps when I received them from him. He just said, "They are the stamps." I didn't question him because he called me previously, he said some man wanted to give him some stamps. I don't know if he bought them, or what he gave for them, but I know I paid for them. Mr. Ruggiero told me the price of the stamps. [54]

Thereupon both parties rested and the following proceedings occurred:

The Court: Is the matter submitted on both sides?

Mr. Ferriter: Yes.

Mr. Colvin: Yes, your Honor.

The Court: I find the defendants and each of them guilty on the three counts charged.

Thereupon the court ordered the cause continued until the 12th day of October 1945 for judgment.

Be It Further Remembered that on the day last aforesaid, after hearing counsel, the court rendered and pronounced judgment that each of the said defendants be fined the sum of \$1,000 on each count of the said indictment, and be imprisoned for a period of six months on each count of said indictment, the said terms of imprisonment in the case of each defendant to run concurrently, all of which from the judgments and sentences of record herein fully and at large appears.

And Now, and Within Due and Legal Time after the pronouncement of the judgments and sentences aforesaid, and within the period of time fixed by law and by the order of the said District Court in the premises, the said defendants present this, their Bill of Exceptions, to be used upon the appeals of said defendants to the United States Circuit Court of Appeals for the Ninth Circuit to reverse the several [55] judgments and sentences aforesaid, and pray that the said Bill of Exceptions be by the Court settled, approved and allowed, and that the same may be a part of the record to be sent to said United States Circuit Court of Appeals.

Dated this 25th day of October, 1945.

(Signed) WM. E. FERRITER

Attorney for Defendant

Amerigo Belluomini.

(Signed) WALTER H. DUANE

Attorney for Defendant

Edgar Ruggiero.

### STIPULATION

It Is Hereby Stipulated by and between counsel for the said defendants, and the United States Attorney for the Northern District of California that the foregoing Bill of Exceptions contains the full substance of all the evidence, and sets forth truly and correctly all of the proceedings taken and had upon the trial of the actions entitled as above, which were consolidated for trial, and that the said Bill of Exceptions is in all respects full, true and correct, and that the same may be used as the Bill of Exceptions upon the aforesaid appeals of said Defendants to the [56] United States Circuit Court of Appeals for the Ninth Circuit.

It Is Further Stipulated that the said Bill of Exceptions shall be the Bill of Exceptions for each and both of the said defendants, and that

the said appeals may be presented and heard upon a single transcript.

/s/ FRANK J. HENNESSY

/s/ By REYNOLD H. COLVIN

United States Attorney for the Northern District  
of California.

/s/ WM. E. FERRITER

Attorney for Defendant

Amerigo Belluomini.

/s/ WALTER H. DUANE

Attorney for Defendant

Edgar Ruggiero.

To the end that the matters and things aforesaid may be and remain of record, the foregoing Bill of Exceptions hereby is settled, approved and allowed as being the Bill of Exceptions on appeal of each of the defendants in each of the above entitled causes or actions, which were consolidated for trial, and that the said Bill of Exceptions contains the full substance of all the evidence taken and had upon the trial of the said consolidated actions, and that the same is in all respects full, true and correct, and that the same be a part of the record herein to be sent to the United States Circuit Court of Appeals for the Ninth Circuit.

Done in Open Court October 31st, 1945.

/s/ MICHAEL J. ROCHE

United States District Judge.

(Service Acknowledged.)

[Endorsed]: Filed Oct. 3, 1945. [57]



In the United States Circuit Court of Appeals for  
the Ninth Circuit

District Court No. 29633-R

AMERIGO BELLUOMINI

Appellant

vs.

UNITED STATES OF AMERICA

Appellee

District Court No. 29635-R

EDGAR RUGGIERO

Appellant

vs.

UNITED STATES OF AMERICA

Appellee

ORDER CONSOLIDATING APPEALS FOR  
HEARING ONE TRANSCRIPT

The causes entitled as above having been consolidated for trial in the United States District Court for the Northern District of California, and the same evidence having been introduced and the same proceedings taken in said District Court upon the one trial as to both causes, and the [58] questions presented by each of said appeals being the same, and there being no necessity for the printing of the record and proceedings in separate transcripts; and counsel for the respective parties having stipulated thereto, it is therefor

Ordered that the said appeals be consolidated for hearing on one transcript, consisting of the pleadings, records and other papers set forth in the praecipe filed by the above named appellants.

Dated this 15th day of November, 1945.

FRANCIS A. GARRECHT

United States Circuit Judge.

[Endorsed]: Filed Nov. 15, 1945. Paul P. O'Brien, Clerk.

The foregoing Order is hereby consented to.

REYNOLD H. COLVIN

Asst. United States Attorney

WILLIAM E. FERRITER

Attorney for Appellant

Amerigo Belluomini

WALTER H. DUANE

Attorney for Appellant

Edgar Ruggiero

A True Copy. Attest: Nov. 15, 1945.

[Seal] /s/ PAUL P. O'BRIEN

Clerk.

[Endorsed]: Filed Nov. 15, 1945. C. W. Calbreath, Clerk. [59]

In the District Court of the United States for  
the Northern District of California, Southern  
Division

No. 29,633-R

UNITED STATES OF AMERICA

vs.

AMERIGO BELLUOMINI,

Defendant.

No. 29,635-R

UNITED STATES OF AMERICA

vs.

EDGAR RUGGIERO,

Defendant.

### PRAECIPE FOR RECORD

To the Clerk:

Kindly furnish the following papers in the causes  
numbered and entitled as above, to be used on the  
appeals of the above named defendants to the  
United States Circuit Court of Appeals for the  
Ninth Circuit:

1. The Caption.
2. The Names and Addresses of Counsel.
3. The Indictment in No. 29633-R.
4. The Indictment in No. 29635-R.

5. The Demurrer of the Defendant Amerigo Belluomini to the Information in No. 29633-R.

6. The Minute Order of the Court Overruling the said Demurrer.

7. The Minutes of the Trial.

8. The settled Bill of Exceptions.

8-a. The Assignment of Errors of each Defendant.

9. The Judgment and Sentence in each case.

10. The Commitment.

11. The Notice of Appeal in No. 29633-R.

12. The Notice of Appeal in No. 29635-R.

13. Stipulation for the Hearing of the Appeals on a Single Transcript.

14. The Praecipe.

Dated: November 2, 1945.

WILLIAM E. FERRITER

Attorney for Defendant

Amerigo Belluomini.

WALTER H. DUANE

Attorney for Defendant

Edgar Ruggiero.

(Service Admitted.)

[Endorsed]: Filed Nov. 15, 1945. [61]

District Court of the United States  
Northern District of California

CERTIFICATE OF CLERK TO TRANSCRIPT  
OF RECORD ON APPEAL

I, C. W. Calbreath, Clerk of the District Court of the United States, for the Northern District of California, do hereby certify that the foregoing 61 pages, numbered from 1 to 61, inclusive, contain a full, true, and correct transcript of the records and proceedings in the consolidated cases of United States of America vs. Amerigo Belluomini, No. 29633-R, and United States of America vs. Edgar Ruggiero, No. 29635-R, as the same now remain on file and of record in my office.

I further certify that the cost of preparing and certifying the foregoing transcript of record on appeal is the sum of \$11.75 and that the said amount has been paid to me by the Attorneys for the appellants herein.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court at San Francisco, California, this 22nd day of December, A. D. 1945.

[Seal]

C. W. CALBREATH,

Clerk

/s/ M. E. VAN BUREN

Deputy Clerk [62]

[Endorsed]: No. 11165. United States Circuit Court of Appeals for the Ninth Circuit. Edgar Ruggiero and Amerigo Belluomini, Appellants, vs. United States of America, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the Northern District of California, Southern Division.

Filed February 13, 1946.

PAUL P. O'BRIEN

Clerk of the United States Circuit Court of Appeals  
for the Ninth Circuit.

No. 11,165

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

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AMERIGO BELLUOMINI,

*Appellant,*

vs.

UNITED STATES OF AMERICA,

*Appellee.*

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EDGAR RUGGIERO,

*Appellant,*

vs.

UNITED STATES OF AMERICA,

*Appellee.*

---

APPELLANTS' OPENING BRIEF.

---

WILLIAM E. FERRITER,

645 Mills Tower, San Francisco 4, California,

*Attorney for Appellant,*

*Amerigo Belluomini.*

WALTER H. DUANE,

790 Mills Building, San Francisco 4, California,

*Attorney for Appellant,*

*Edgar Ruggiero.*





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### I.

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No. 11,165

IN THE

# United States Circuit Court of Appeals

For the Ninth Circuit

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AMERIGO BELLUOMINI,

vs.

*Appellant,*

UNITED STATES OF AMERICA,

*Appellee.*

EDGAR RUGGIERO,

vs.

*Appellant,*

UNITED STATES OF AMERICA,

*Appellee.*

## APPELLANTS' OPENING BRIEF.

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Separate informations were filed against the appellants in the United States District Court for the Northern District of California, each of which was in three counts based upon alleged violations of certain general ration orders issued by the Office of Price Administration under the purported authority of the Second War Powers Act, it being charged in substance that each of the defendants acquired, possessed and transferred certain forged and counterfeited red meat-ration stamps. The two Informations were consoli-

dated for trial by stipulation and were tried by the District Judge, without a jury, trial by jury having been waived. (Tr. p. 17.) The Court found each of the defendants guilty upon all three counts, and sentenced each of them to be fined in the sum of one thousand dollars on each count of the Information, and to be imprisoned for a period of six months on each count, the terms of imprisonment in the case of each defendant to run concurrently. (Tr. pp. 19, 23.) From the judgments so pronounced against them, each of the appellants has duly appealed to this Honorable Court, the appeals being presented, pursuant to stipulation of counsel and the order of this Court, on a single transcript.

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### **JURISDICTIONAL STATEMENT.**

#### **(1) The jurisdiction of the District Court.**

*U.S.C.A.*, Title 28, Section 41, subdivision 2. This section provides that the District Courts shall have original jurisdiction of "all crimes and offenses cognizable under the authority of the United States". Also, the *Constitution of the United States, Amendment 6*:

"In all criminal prosecutions the accused shall enjoy the right to a speedy and public trial by an impartial jury of the state and district wherein the crime shall have been committed."

- (2) The jurisdiction of this Court upon appeal to review the judgment in question.

*U.S.C.A.*, Title 28, Section 225:

“The Circuit Courts of Appeal shall have appellate jurisdiction to review by appeal final decisions,—

“First, in the District Court, in all cases save where a direct review of the decision may be had in the Supreme Court, under section 345 of this Title.”

- (3) The pleadings necessary to show the existence of jurisdiction.

(a) The Informations. (Tr. pp. 2, 6.)

(b) The Demurrer of Amerigo Belluomini. (Tr. p. 10.)

- (4) The facts disclosing the basis upon which it is contended that the District Court had jurisdiction and that this Court has jurisdiction upon appeal to review the judgment in question.

These facts are set forth in the introductory sentences to this brief and will be stated more fully in the ensuing abstract of the case. Accordingly, in the interest of brevity and to avoid repetition, statement thereof is here omitted.

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**A CONCISE ABSTRACT OR STATEMENT OF THE CASE PRESENTING SUCCINCTLY THE QUESTIONS INVOLVED AND THE MANNER IN WHICH THEY ARE PRESENTED.**

The charging part of the Information against the appellant Belluomini reads as follows;

“That Amerigo Belluomini (hereinafter called ‘said defendant’), did, on or about the 7th day of May, 1945, in the City and County of San Francisco, State of California, within the Southern Division of the Northern District of California, and within the jurisdiction of this Court, wilfully and unlawfully acquire, possess and control certain counterfeited and forged ration documents, to-wit: 5000 red meat ration stamps, under circumstances which would be in violation of Section 2.6 of General Ration Order No. 8 if the said counterfeited and forged ration documents were genuine, that is to say, the said defendant was not then and there, or at any time, a person, or the agent of a person, to whom said ration documents were issued, or by whom said ration documents were acquired in accordance with the provisions of any Ration Order, or a person, or the agent of a person by whom said ration documents were acquired, possessed and controlled as otherwise provided by any Ration Order. (General Ration Order No. 8, Sections 2.5 and 2.6, 8 F.R. 3783; General Ration Order No. 14, 8 F.R. 14211; General Ration Order No. 16, 9 F.R. 6731.)

“That said defendant, Amerigo Belluomini, on or about the 23rd day of May, 1945, in the City and County of San Francisco, State of California, within the Southern Division of the Northern District of California, and within the jurisdiction of this Court, did unlawfully, wilfully and knowingly transfer to one Leondro Messaglia certain counterfeited and forged ration documents, to-wit: 2500 red meat ration stamps, under circumstances which would be in viola-



tion of Section 2.6 of General Ration Order No. 8 if the said counterfeited and forged ration documents were genuine, that is to say, the said defendant did then and there transfer said 2500 red meat ration stamps to the said Leondro Messaglia otherwise than in a way permitted and otherwise than for a purpose permitted by any Ration Order. (General Ration Order No. 8, Sections 2.5 and 2.6, 8 F.R. 3783; General Ration Order No. 14, 8 F.R. 14211; General Ration Order No. 16, 9 F.R. 6731.)

“That the said defendant, Amerigo Belluomini, on or about the 9th day of May, 1945, in the City and County of San Francisco, State of California, within the Southern Division of the Northern District of California, and within the jurisdiction of this Court, did unlawfully, wilfully and knowingly transfer to one Bank of America National Trust and Savings Association, 37th Avenue and Balboa Street Branch, San Francisco, California, certain counterfeited and forged ration documents, to-wit: 2500 red meat ration stamps, under circumstances which would be in violation of Section 2.6 of General Ration Order No. 8 if the said counterfeited and forged ration documents were genuine, that is to say, the said defendant did then and there transfer said 2500 red meat ration stamps to the said Bank of America National Trust and Savings Association, 37th Avenue and Balboa Street Branch, San Francisco, California, otherwise than in a way permitted and otherwise than for a purpose permitted by any Ration Order. (General Ration Order No. 8, Sections 2.5 and 2.6, 8 F.R. 3783;

General Ration Order No. 14, 8 F.R. 14211; General Ration Order No. 16, 9 F.R. 6731.)”

The Information filed against appellant Ruggiero is in all respects identical with the foregoing Information against Belluomini with the exception that the number of stamps mentioned in the first count is 8,700; in the second count, 5,000 and in the third count, 3,780; the stamps mentioned in the second count are alleged to have been transferred to the appellant Belluomini; and a different banking institution is named in the third count.

The appellant Belluomini filed a demurrer to the Information against him, on the following grounds:

#### I.

That the said First Count of said Information does not state facts sufficient to charge this defendant with any crime or offense against the United States.

#### II.

That said First Count of said Information is bad for uncertainty in each of the following particulars, to-wit:

(a) That the said First Count alleges that the said defendant did wilfully and unlawfully acquire, possess and control certain counterfeit and forged ration documents, but that the said documents are not, nor is any of said documents, set forth either according to its tenor or according to its purport;

(b) That it cannot be ascertained therefrom whether the documents alleged to have been counter-

feited and forged were counterfeits or forgeries of any documents issued by the United States of America or by any department, agency, board or officer thereof having authority to issue the same;

(c) That it cannot be ascertained therefrom how or in what manner said defendant was not a person or the agent of a person by whom said ration documents were acquired in accordance with the provisions of any ration order, or a person or the agent of a person by whom said ration documents were acquired, possessed or controlled as otherwise provided by any ration order;

(d) That it cannot be ascertained therefrom how or in what manner the said defendant violated any provision of any so-called ration order.

### III.

That the said Second Count of said Information does not state facts sufficient to charge this defendant with any crime or offense against the United States.

### IV.

That said Second Count of said Information is bad for uncertainty in each of the following particulars, to-wit:

(a) That the said Second Count alleges that the said defendant did unlawfully, wilfully and knowingly transfer certain counterfeited and forged ration documents, but the said documents are not, nor is any of said documents, set forth either according to its tenor or according to its purport;

(b) That it cannot be ascertained therefrom whether the documents alleged to have been counterfeited and forged were counterfeits or forgeries of any documents issued by the United States of America or by any department, agency, board or officer thereof having authority to issue the same;

(c) That it cannot be ascertained therefrom how or in what manner the transfer of the so-called meat ration stamps therein referred to was otherwise in a way permitted or otherwise than for a purpose permitted by any ration order.

(d) That it cannot be ascertained therefrom how or in what manner the said defendant violated any provision of any so-called ration order.

## V.

That the said Third Count of said Information does not state facts sufficient to charge this defendant with any crime or offense against the United States.

## VI.

That said Third Count of said Information is bad for uncertainty in each of the following particulars, to-wit:

(a) That the said Third Count alleges that the said defendant did unlawfully, wilfully and knowingly transfer to one Bank of America National Trust and Savings Association, 37th Avenue and Balboa Street Branch, San Francisco, California, certain counterfeited and forged ration documents, but the said documents are not, nor is any of said documents, set forth

either according to its tenor or according to its purport.

(b) That it cannot be ascertained therefrom whether the documents alleged to have been counterfeited and forged were counterfeits or forgeries of any documents issued by the United States of America or by any department, agency, board or officer thereof having authority to issue the same;

(c) That it cannot be ascertained therefrom how or in what manner the transfer of the so-called meat ration stamps therein referred to as alleged in said count was otherwise than in a way permitted or otherwise than for a purpose permitted by any ration order;

(d) That it cannot be ascertained therefrom how or in what manner the said defendant violated any provision of any so-called ration order.

## VII.

That this Honorable Court has no jurisdiction of the above entitled cause or to hear or determine the said information, or to try this defendant thereon or as to any count thereof, for the reason that General Ration Order 8 is unconstitutional and void, and that no criminal prosecution will lie for any alleged violation of any of the provisions of said order, for the reason that Section 3.1 of Article III of said General Ration Order purports and attempts to punish the violation of the said order or any other ration order as a crime and fixes the penalty therefor; and that the Price Administrator has no power to declare what

acts shall be criminal or shall constitute crimes, or to determine the punishments for any act; that no statute of the United States, and no act of Congress, confers upon the Price Administrator the power to define or to punish crimes and that if any act of Congress can be construed as an authorization of said Price Administrator to define and punish crimes, or to declare that any act shall constitute a crime and fix the punishment therefor, such act is to that extent unconstitutional and void, and in violation of the provision of the Fifth Amendment to the Constitution of the United States that no person shall be deprived of life, liberty or property without due process of law, and is an unlawful delegation of legislative powers which are vested by the Constitution of the United States in the Congress alone.

(Tr. 10, *et seq.*)

This demurrer was overruled by the District Court, and an exception noted. (Tr. 16.)

Thereafter, and on October 9, 1945, the said actions, consolidated for trial as heretofore stated, came on regularly to be heard in the District Court before Honorable Michael J. Roche, sitting without a jury.

The evidence, as set forth in the Bill of Exceptions, may be very briefly summarized:

E. W. Slade, called by the Government, testified:

"I have charge of the Regional Verification Center of the Office of Price Administration, 1267 Mission Street, San Francisco. The function of the Verification Center is to examine all ration currencies de-

posited in the bank after the public has used them. These examinations are done in my presence and under my supervision. I was so employed during the month of May 1945. I have been in the Verification Center since its inception in the Spring of 1944. I saw Government's Exhibits 1-A to 1-H, inclusive, for Identification, on May 22, 1945. These envelopes were brought to me after they had been opened and the contents found to be counterfeits. I was asked to verify the counterfeit nature of the evidence. After a conference I typed the counterfeits CFM-4. These envelopes contained 500 counterfeits each, except the last one. There are 7 envelopes, each of which contained 500 counterfeits, and the last one contained 280 counterfeit stamps. The last one, to which I have just referred, was Government's Exhibit 1-B for Identification. After examining the envelopes and the contents, I typed the counterfeits; they were noted in the upper right hand of the envelope, I initialed the envelopes and the date of examination, and then I returned the evidence to the Special Agent of the Office of Price Administration, Mr. Reimel. I designated these envelopes by the code number, which was CFM-4. The stamps contained in those envelopes were not of a nature which could at any time be transferred as ration coupons. As soon as we discovered the evidence, I telephoned Mr. Reimel, who came over to the Verification Center. I handed the evidence over to him May 22. The five envelopes now shown me, which are marked Government's Exhibits for Identification 2-A to 2-E, inclusive, were brought to me

by Mr. Reimel. I was asked to examine the contents of these envelopes and having done so I made a notation on the face of each, 'Checked May 25, 1945'. So I assume that was the date on which I examined those envelopes. Mr. Reimel was present. I examined these five envelopes and found that each of them contained 500 counterfeit ration stamps of the same type as we have previously found in the other matter. When counterfeits are found, they are classified as to type. During May we came across about 5 different types of counterfeits in this region. These types are assigned by the national office of Washington. When we run across a new counterfeit, we obtain the type number which has been already assigned to it, or, if a new counterfeit, a new number is assigned to it by the national office in Washington. The coupons contained in the envelopes marked '2-A' to '2-E' for Identification, inclusive, were the same type as the coupons contained in the envelopes marked Government's Exhibits '1-A' to '1-H', inclusive. That type of coupons we never issue for valid use under the rationing regulations. Each envelope contains 500 counterfeits. I found no genuine coupons in either Government's Exhibits 1-A to 1-H inclusive, or in Government's Exhibits 2-A to 2-E, inclusive."

(Tr. 37 *et seq.*)

James Reimel, special assistant to the legislative auditor of the State of California, who was employed by the Office of Price Administration during the month of May 1945, testified that he took the ration stamps numbered Exhibits 1-A to 1-H inclusive to the



Tunnel Meat Market on West Portal Avenue in San Francisco and showed them to the defendant Ruggiero, explaining to him that they were counterfeit. Ruggiero stated at that time that he did not have any knowledge of the source of those stamps but that they had been placed by him in the West Portal branch of the Bank of America. He further stated that he was not the owner of the market but was conducting the same for the defendant Belluomini. Later on that same day, to-wit, May 22, 1945, the witness drove to the place of business operated by the defendant Belluomini at 37th Avenue and Balboa Street, San Francisco, where he saw the defendants engaged in a conversation. He then walked in and spoke to Ruggiero.

(Tr. 41-43.)

The witness further testified, referring to Ruggiero:

“He said he had some more to tell me about the stamps. We stepped outside the shop. I sat in the car which I had been driving, and at that time Mr. Ruggiero stated that he could tell me now where he got the stamps. He stated that on or about May 5 a person came into the shop, the shop he was managing, the Tunnel Market, and bought some meat. This person came in a few times later, maybe two or three times later and made a habit of talking with Ruggiero. Finally he stated he wanted some steak, was willing to pay any price but was short of stamps and would Ruggiero let him have enough points. Mr. Ruggiero said no, that he was up against it for points himself and with that the stranger stated that he

could supply Mr. Ruggiero with some points at a later date if he would be interested. According to Mr. Ruggiero, he stated, 'Well, what butcher wouldn't be interested in getting more stamps!' So a few days after that this individual called Mr. Ruggiero by telephone, stated he now had 8,700 stamps which he would be willing to sell to Mr. Ruggiero for a price of \$1,820 cash. Mr. Ruggiero said that previous to this telephone conversation he had talked the matter over with Mr. Belluomini. Mr. Belluomini was agreeable to take some stamps, although he didn't want as many as he finally got, according to both he and Ruggiero. After the telephone conversation Ruggiero went to the bank, West Portal Branch, there cashed a check for \$1,820 to get the cash to pay off this seller of the counterfeit stamps. Ruggiero after getting the cash returned to the shop. A few minutes later the gentleman came in and left him 8,700 stamps, each worth 10 points. After he received the stamps he turned 5,000 stamps over to Mr. Belluomini and the other 3,700—3,800 he deposited in the West Portal Branch of the Bank of America. On or about May 19 they were sent by that bank to the verification center where Mr. Slade on the 22d of May discovered them and called our office. I have seen Government's for Identification numbers 2-A to 2-E inclusive, consisting of 5 envelopes. I acquired these envelopes containing stamps from the Bank of America in the 3700 block of Balboa Street in San Francisco, from the assistant cashier, whose name appears on the back of the envelope. Mr.

Amerigo Belluomini was present at that time. On the evening of May 22, after I had talked with Mr. Ruggiero, Mr. Belluomini was brought into the conversation a little later, and stated that he had deposited some of the stamps which he got from Mr. Ruggiero in the bank on Balboa Street. At that time it was agreed that on the following morning I would call on Mr. Belluomini and he and I together would go to the Bank of America and there check to see if these stamps still were there. He had a record showing that he had deposited 25,000 points at the Bank of America on May 9. Twenty-five thousand points would be 2,500 stamps. On the following morning, Mr. Belluomini and myself went down to the bank and talked to the assistant manager in charge of the bank, who permitted us to go in and look at the deposit made by Mr. Belluomini. We examined the envelopes. Most of them I slit open in the presence of the cashier and Mr. Belluomini, and examined the stamps. Out of his deposit we located these five envelopes. Mr. Belluomini placed his signature at the top and bottom of each one the day we acquired them from the bank. I had a conversation, which I have not yet related, with the defendant Belluomini, on May 23. I asked Mr. Belluomini what had happened to the balance of the stamps. He told me he had acquired 5,000 and Mr. Ruggiero said he had turned over 5,000 stamps, yet we only found 2,500 in the bank depository. He then related that one of his friends who occasionally worked for him, kept his books, and made deposits at the bank for him, whose name is

Leo Messaglia, had been in the butcher shop on the same evening that I was there, May 22, just previous to my getting there, and at that time Mr. Belluomini and Mr. Ruggiero had talked the matter over. They knew they had bad stamps. They advised Mr. Messaglia to destroy the balance which he was supposed to have in his home. Mr. Messaglia lives over in Fairfax. According to Mr. Messaglia, he went home that night and placed the 2,500 stamps, counterfeit stamps, in his stove and burned them up because he was advised that I would want to see him. On the evening of May 22, Mr. Messaglia, Mr. Belluomini and Mr. Ruggiero were in my office at 1355 Market Street, and there reduced their information and statements to affidavit form. They accompanied me willingly. Three of the persons named, and I believe Miss Paige, my stenographer, were present during the conversation. I don't recall any other person present at that time; there may have been. That statement may have been made May 23d, I am not exact about that. It was either the day I first talked with Ruggiero or the following day. I advised them that the statement was to be given voluntarily, and they were not threatened or promised, nor were they told they would escape prosecution at any time. I advised them of my official position."

(Tr. 43 *et seq.*)

Statements in writing made by each of the defendants, each statement being witnessed by the other defendant, were introduced in evidence.

Ruggiero, in his statement, claimed that he purchased approximately 87,000 red meat-stamps from a man whose name he did not know, paying him \$1820 therefor. Fifty thousand of these he turned over to Belluomini, and the other 37,800 he deposited in his ration bank account in the West Portal branch of the Bank of America. He did not know at the time that the stamps were counterfeit, and did not stop to consider the source of the stamps.

(Tr. 47-51.)

Belluomini, in his statement, confined the declaration of Ruggiero in regard to the transfer of the stamps. Twenty-five thousand of these points were placed in the custody of Leo Messaglia, who further stated that he never knew that the stamps were counterfeit.

The defendant Ruggiero testified that during the month of April, 1945, the Tunnel Market was burglarized, and almost 30,000 red points were stolen.

"I got my stamps previous to the time I got that card. Some time early in May I had some ration stamps, but not enough to operate with. On the occasion I had the conversation with the man that I referred to in my statement, I had very few stamps on hand. I may have been overdrawn in the bank at that time, I don't know exactly how the checks were that were outstanding. I was pretty close to being overdrawn. Maybe I had a thousand on deposit. I don't know how close I was. I received those stamps from the ration board as a replacement. I

purchased those stamps from this man and paid him \$1820 for it. I drew a check payable to myself and went to the bank with that check and cashed it, and paid this man for the stamps. I gave some 50,000 points to Mr. Belluomini. I did not know at the time I purchased these stamps that they were counterfeited stamps. I made good some 37,800 points to the bank. I made the check payable to the Office of Price Administration, and they deducted from my account. I have never been in any difficulty before.”

. (Tr. 56-59.)

The defendant Belluomini testified:

“I am 53 years of age, a veteran of the last World War, and a married man. I admit I got 50,000 of these points from my employee Mr. Ruggiero. The matters and things that Mr. Ruggiero testified to I also admit, as well as my statement, which has been read to the court here. I did not have any knowledge whatsoever of the counterfeit or false nature of these stamps. I recall meeting my employee, a Leo Masaglia, in my butcher shop and market on Balboa Street on the evening of May 22. That is the first time I met Mr. Reimel. I never [had] seen Mr. Reimel before. He was standing outside. Mr. Reimel afterward came in. I know that conversation with Mr. Ruggiero while he was outside. Before the meeting Mr. Ruggiero told me the stamps were not good. I did not know that. I went outside and met Mr. Reimel at the car. At that time I told him I also had some stamps. He did not accuse me of hav-

ing any stamps. I voluntarily told him. I also had some of the stamps. I told him that I deposited some of them, 25,000. Subsequently I took him myself to the bank to get those stamps. I run this particular butcher shop at 37th and Balboa. I have been engaged in the meat business pretty near 40 years. I sell a great deal of meat. I have not been able to sell as much meat during this war as I did prior to the war. I would have sold a lot more if I would have got it, but I was not getting very much meat. The operation of my business caused me to lose stamp values. Waste the meat; you can't control all the men. We have four or five butchers. There was a constant loss of points. In my business I was forced to lose points by the manner in which I bought meat. That is one of the reasons why I wanted these stamps. I wanted to stay in business."

(Tr. 60-61.)

Both sides having rested the case, the Court found each of the defendants guilty on all three counts, and, on the 12th day of October, 1945, pronounced judgment that each of the defendants be fined the sum of \$1000 on each count of the Information and be imprisoned for a period of six months on each count of the Information, the terms of imprisonment in the case of each defendant to run concurrently. (Tr. 62.)

From the aforesaid judgments, each of the defendants has duly appealed to this Court (Tr. 25, 29), the appeals being presented on a single transcript pursuant to stipulation, the evidence being set forth in

a single bill of exceptions. Separate assignments of error were filed; but these are identical with this single exception, that the first assignment of the appellant Belluomini sets forth that the District Court erred in overruling Belluomini's demurrer to the Information and to each of the several counts thereof. The appellant Ruggiero filed no demurrer, but in his first assignment of errors he raises the point that neither the Information nor any of the several counts thereof charges him with any crime against the United States, and that the District Court accordingly had no jurisdiction to render the aforesaid judgment and sentence.

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**SPECIFICATION OF THE ASSIGNED ERRORS  
RELIED UPON.**

Appellant Belluomini's Assignment No. 1. (Tr. 32.)

Appellant Belluomini's Assignment No. 2. (Ruggiero's Assignment No. 1.) (Tr. 34.)

Appellant Belluomini's Assignment No. 3. (Ruggiero's Assignment No. 2.) (Tr. 33, 34.)

Appellant Belluomini's Assignment No. 4. (Ruggiero's Assignment No. 3.) (Tr. 33, 34.)

Appellant Belluomini's Assignment No. 5. (Ruggiero's Assignment No. 4.) (Tr. 33, 34.)



## ARGUMENT.

## I.

NEITHER OF THE INFORMATIONS, NOR ANY OF THE COUNTS IN EITHER, CHARGES ANY CRIME AGAINST THE UNITED STATES. THE DISTRICT COURT, THEREFORE, ERRED IN OVERRULING THE DEMURRER OF THE APPELLANT BELLUOMINI, AND THE JUDGMENT IN EACH CASE IS A NULLITY FOR THE REASON THAT THE DISTRICT COURT HAD NO JURISDICTION IN EITHER.

Appellant Belluomini's Assignment No. 1.

"That the said District Court erred in overruling the demurrer of this defendant to the Information in the above entitled cause."

Appellant Belluomini's Assignment No. 2.

(Appellant Ruggiero's Assignment No. 1.)

"That the said Information does not, nor does any of the several counts thereof, charge this defendant with any crime or offense against the United States of America, and that said District Court accordingly had no jurisdiction to hear or determine the same, or to render judgment or pass sentence upon this defendant."

The demurrer of the appellant Belluomini heretofore set forth fully and specifically points out the particulars wherein the Informations and each of the several counts of each fails to charge any crime against the United States.

The several Informations and the judgment passed thereon against these appellants are wholly void, and the District Court had no jurisdiction of either of the actions or proceedings and was without power to

render judgment or pass sentence upon either of the appellants, for the following reasons:

- (a) No statute or act of Congress makes criminal or unlawful, or provides any penalty or punishment for, the violation of any ration order.

The *Emergency Price Control Act* (U.S.C.A. 50, Appx.), which creates the office of Price Administrator, does not confer upon that official the power to ration food or other commodities. His powers are limited by the act to the regulation and fixing of maximum prices for **commodities** and to the fixing of maximum rents in defense areas.

Section 902(a) of the *Emergency Price Control Act* confers upon the Price Administrator the power to establish maximum **prices** whenever prices of a commodity or commodities have risen or threaten to rise to an extent inconsistent with the purposes of the act. He also is given the power to issue temporary regulations or orders establishing a maximum price or prices prevailing with respect to any commodity, but such temporary regulation or order shall be effective for not more than 60 days.

Subdivision (b) of the same section gives the Administrator the power to establish maximum **rents** for defense area housing accommodations within "a particular defense-rental area."

These are the only powers conferred upon the Administrator by the Act, any other powers being conferred solely for the purpose of carrying into effect the power to regulate the rents and the price of com-

modities. The sole prohibitions contained in the act are set forth in section 904, which reads as follows:

“It shall be unlawful, regardless of any contract, agreement, lease, or other obligation heretofore or hereafter entered into, for any person to sell or deliver any commodity, or in the course of trade or business to buy or receive any commodity, or to demand or receive any rent for any defense-area housing accommodations, or otherwise to do or omit to do any act, *in violation of* any regulation or order under section 2 [section 902 of this Appendix], or of any price schedule effective in accordance with the provisions of section 206 [section 926 of this Appendix], or of any regulation, order, or requirement under section 202 (b) or section 205 (f) [sections 922 (b) or 925 (f) of this Appendix], or to offer, solicit, attempt, or agree to do any of the foregoing.

(b) It shall be unlawful for any person to remove or attempt to remove from any defense-area housing accommodations the tenant or occupant thereof or to refuse to renew the lease or agreement for the use of such accommodations, because such tenant or occupant has taken, or proposes to take, action authorized or required by this Act or any regulation, order, or requirement thereunder.

(c) It shall be unlawful for any officer or employee of the Government, or for any adviser or consultant to the Administrator in his official capacity, to disclose, otherwise than in the course of official duty, any information obtained under this Act, or to use any such information, for personal benefit.

(d) Nothing in this Act shall be construed to require any persons to sell any commodity or to offer any accommodations for rent."

Section 925 (b) of the Act provides:

"Any person who willfully violates any provision of section 4 of this Act [section 904 of this Appendix], and any person who makes any statement or entry false in any material respect in any document or report required to be kept or filed under section 2 or section 202 [sections 902 or 922 of this Appendix], shall, upon conviction thereof, be subject to a fine of not more than \$5,000, or to imprisonment for not more than two years in the case of a violation of section 4 (c) [section 904 (c) of this Appendix] and for not more than one year in all other cases, or to both such fine and imprisonment. Whenever the Administrator has reason to believe that any person is liable to punishment under this subsection, he may certify the facts to the Attorney General, who may in his discretion, cause appropriate proceedings to be brought."

We have set forth the foregoing provisions of the statute *in haec verba* in order to demonstrate that the Emergency Price Control Act, as far as applicable to the question here involved, only prohibits and punishes the following acts:

1. The selling or delivery, or the buying or receiving, of any commodity in violation of any price regulation issued by the Administrator, or
2. Demanding or receiving any rent for any defense area housing accommodations, or otherwise doing or

omitting to do, any act, in violation of any regulation or order under section 902, which deals solely with rents and the **price** of commodities.

Neither in any place nor in any part of the Emergency Price Control Act is the Administrator given the power to **ration** any commodity whatsoever. The act does not purport or attempt to confer upon him the authority to prescribe **what quantity of any commodity** any dealer in commodities or any consumer may possess or use. Such power not having been conferred upon him by the Act, it is obviously lacking unless it be conferred upon him by some other statute.

We must look elsewhere, therefore, for the authority to ration commodities.

On December 18, 1941, Congress passed what is commonly known as the *First War Powers Act* (U.S.C.A. Title 50, Appx., secs. 601-622).

Section 601 of this Act reads as follows:

**“Coordination of executive bureaus, offices, etc., by President for national defense and to prosecute the war; issuance of regulations.**

“For the national security and defense, for the successful prosecution of the war, for the support and maintenance of the Army and Navy, for the better utilization of resources and industries, and for the more effective exercise and more efficient administration by the President of his powers as Commander in Chief of the Army and Navy, the President is hereby authorized to make such redistribution of functions among executive agencies as he may deem necessary, including

any functions, duties and powers hitherto by law conferred upon any executive department, commission, bureau, agency, governmental corporation, office, or officer, in such manner as in his judgment shall seem best fitted to carry out the purposes of this title [sections 601-605 of this Appendix], and to this end is authorized to make such regulations and to issue such orders as he may deem necessary, which regulations and orders shall be in writing and shall be published in accordance with the Federal Register Act of 1935 [sections 301-310, 311-314 of Title 44]: *Provided*, That the termination of this title [sections 601-605 of this Appendix], shall not affect any act done or any right or obligation accruing or accrued pursuant to this title [sections 601-605 of this Appendix] and during the time that this title [sections 601-605 of this Appendix], is in force: *Provided further*, That the authority by this title [sections 601-605 of this Appendix], granted shall be exercised only in matters relating to the conduct of the present war: *Provided further*, That no redistribution of functions shall provide for the transfer, consolidation, or abolishment of the whole or any part of the General Accounting Office or of all or any part of its functions."

It will be noted that this sweeping grant of power by Congress to the President does not confer upon the chief executive any authority, either express or implied, to ration food or other necessities of life. **This power was conferred by the President upon himself.**

On December 5, 1942, the President issued Executive Order No. 9280 (7 F.R. 10179), which is en-

titled, "*Delegating Authority With Respect to Nation's Food Program.*"\*

\*The text of the Executive Order No. 9280, so far as pertinent to the instant case, is as follows:

"By virtue of the authority vested in me by the Constitution and the statutes of the United States, as President of the United States and Commander in Chief of the Army and Navy, and in order to assume an adequate supply and efficient distribution of food to meet war and essential civilian needs, it is hereby ordered as follows:

"1. The Secretary of Agriculture (hereinafter referred to as the 'Secretary') is authorized and directed to assume full responsibility for and control over the Nation's food program. In exercising such authority, he shall:

"a. Ascertain and determine the direct and indirect military, other governmental, civilian, and foreign requirements for food, both for human and animal consumption and for industrial uses.

"b. Formulate and carry out a program designed to furnish a supply of food adequate to meet such requirements, including the allocation of the agricultural productive resources of the Nation for this purpose.

"c. Assign food priorities and make allocations of food for human and animal consumption to governmental agencies and for private account, for direct and indirect military, other governmental, civilian, and foreign needs.

"d. Take all appropriate steps to insure the efficient and proper distribution of the available supply of food.

"e. Purchase and procure food for such Federal agencies, and to such extent, as he shall determine necessary or desirable, and promulgate policies to govern the purchase and procurement of food by all other Federal agencies: *Provided*, That nothing in this subsection shall limit the authority of the armed forces to purchase or procure food outside the United States or in any theater of war as such purchase and procurement shall be required by military or naval operations, or the authority of any other authorized agency to purchase or procure food outside the United States for rehabilitation or relief purposes abroad. Existing methods for the purchase and procurement of food by other Federal agencies shall continue until otherwise determined by the Secretary pursuant to this Executive Order.

"2. The Secretary shall recommend to the Chairman of the War Production Board the amounts and types of non-food materials, supplies, and equipment necessary for carrying out the food program. Following consideration of these recommendations, the Chairman of the War Production Board shall allocate stated amounts of non-food materials, supplies, and equipment to the Secretary for carrying out the food program; and the War

This order does not purport to be based upon any Act of Congress, but is a right assumed by the President "as President of the United States and Commander in Chief of the Army and Navy."

This executive order is the only source of the purported power or authority of the Office of Price Administration to ration food for civilians.

To state the matter otherwise,—the penalties provided in the Emergency Price Control Act have no application to rationing orders, because in making

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Production Board, through its priorities and allocation powers, shall direct the use of such materials, supplies, and equipment for such specific purposes as the Secretary may determine.

"3. Whenever the available supply of any food is insufficient to meet both food and industrial needs the Chairman of the War Production Board and the Secretary shall jointly determine the division to be made of the available supply of such food. In the event of any difference of view between the Chairman of the War Production Board and the Secretary, such difference shall be submitted for final determination to the President or to such agent or agency as the President may designate.

"4. The Secretary, after determining the need and the amount of food available for civilian rationing, shall, through the Office of Price Administration, exercise the priorities and allocation powers conferred upon him by this Executive Order for civilian rationing, with respect to (a) the sale, transfer, or other disposition of food by any person who sells at retail to any person, and (b) the sale, transfer, or other disposition of food by any person to an ultimate consumer, as is currently provided for in War Production Board Directive No. 1, dated January 24, 1942, and existing supplements thereto; and with respect to (c) the sale, transfer, or other disposition of food by any person at such other levels of distribution as he may determine; and in the administration or enforcement of any such priorities or allocation authority for civilian rationing, the Office of Price Administration, subject to the provisions of this Executive Order, is hereby authorized to exercise all the functions, duties, powers, authority, or discretion conferred upon the Price Administrator by Section 3 of Executive Order 9125 of April 7, 1942. The Secretary, before determining the time, extent, and other conditions of civilian rationing, shall consult with the Price Administrator."



such orders the Office of Price Administration does not act under the Price Control Act at all, but under the executive order by which the President attempts to delegate to the Secretary of Agriculture the power to make such orders through the Office of Price Administration.

Moreover,—and this is the all-important and decisive factor in the instant case,—the *First War Powers Act* does not prescribe any penalty whatsoever for the violation of any rationing order or other executive order. The sole penalty provided anywhere in that Act is contained in section 618, U.S.C.A. Title 50, which makes it a crime to evade the regulations that may be prescribed by the President for the censorship of communications between the United States and any foreign country.

The Information in the case at bar purports to be based upon Section 301 of Title III of the *Second War Powers Act*, passed on March 27, 1942. (U.S.C.A. Title 50, Appx., sec. 633.) This section is entitled “*Priorities Powers*,” and relates solely to the placing of government contracts by the Secretary of War or the Secretary of the Navy for the construction of naval vessels or aircraft and for the assignment of priorities of materials for defense purposes. **Not one word is said in that section or in any of the subdivisions thereof with reference to the rationing of food.** That this section has no application to the matters and things charged in the Information or shown by the evidence in the case at bar, is apparent from the wording of

the section, the text of which is printed in the margin.\*

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\*“(a)(1) That whenever deemed by the President of the United States to be in the best interests of the national defense during the national emergency declared by the President on September 8, 1939, to exist, the Secretary of the Navy is hereby authorized to negotiate contracts for the acquisition, construction, repair, or alteration of **complete naval vessels or aircraft, or any portion thereof**, including plans, spare parts, and equipment therefor, that have been or may be authorized, and also for machine tools and other similar equipment, with or without advertising or competitive bidding upon determination that the price is fair and reasonable. Deliveries of material under all orders placed pursuant to the authority of this paragraph and all other naval contracts or orders and deliveries of material under all Army contracts or orders shall, in the discretion of the President, take priority over all deliveries for private account or for export: *Provided*, That the Secretary of the Navy shall report every three months to the Congress the contracts entered into under the authority of this paragraph: *Provided further*, That contracts negotiated pursuant to the provisions of this paragraph shall not be deemed to be contracts for the purchase of such materials, supplies, articles, or equipment as may usually be bought in the open market within the meaning of section 9 of the Act entitled ‘An Act to provide conditions for the purchase of supplies and the making of contracts by the United States, and for other purposes’, approved June 30, 1936 (49 Stat. 2036; U.S.C., Supp. V, title 41, secs. 35-45): *Provided further*, That nothing herein contained shall relieve a bidder or contractor of the obligation to furnish the bonds under the requirements of the Act of August 24, 1935 (49 Stat. 793; 40 U.S.C. sec. 270 (a) to (d)): *Provided further*, That the cost-plus-a-percentage-of-cost system of contracting shall not be used under the authority granted by this paragraph to negotiate contracts; but this proviso shall not be construed to prohibit the use of the cost-plus-a-fixed-fee form of contract when such use is deemed necessary by the Secretary of the Navy; *And provided further*, That the fixed fee to be paid the contractor as a result of any contract entered into under the authority of this paragraph, or any War Department contract entered into in the form of cost-plus-a-fixed-fee, shall not exceed 7 per centum of the estimated cost of the contract (exclusive of the fee as determined by the Secretary of the Navy or the Secretary of War, as the case may be).

“(2) Deliveries of material to which priority may be assigned pursuant to paragraph (1) shall include, in addition to

It will thus be observed that Congress only made it a crime to violate the provisions of the section relating to contracts for the building of war ships and planes and priorities and allocations thereof.

**There is no act of Congress making it a crime to violate a food rationing regulation.**

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deliveries of material under contracts or orders of the Army or Navy, deliveries of material under—

“(A) Contracts or orders for the government of any country whose defense the President deems vital to the defense of the United States under the terms of the Act of March 11, 1941, entitled ‘An Act to promote the defense of the United States’ [Title 22, sec. 411 et seq.] ;

“(B) Contracts or orders which the President shall deem necessary or appropriate to promote the defense of the United States;

“(C) Subcontracts or suborders which the President shall deem necessary or appropriate to the fulfillment of any contract or order as specified in this subsection (a).

Deliveries under any contract or order specified in this subsection (a) may be assigned priority over deliveries under any other contract or order, and the President may require acceptance of and performance under such contracts or orders in preference to other contracts or orders for the purpose of assuring such priority. Whenever the President is satisfied that the fulfillment of requirements for the defense of the United States will result in a shortage in the supply of any material or of any facilities for defense or for private account or for export, the President may allocate such material or facilities in such manner, upon such conditions and to such extent as he shall deem necessary or appropriate in the public interest and to promote the national defense.

“(3) The President shall be entitled to obtain such information from, require such reports and the keeping of such records by, make such inspection of the books, records, and other writings, premises or property of, any person (which, for the purpose of this subsection (a), shall include any individual, partnership, association, business trust, corporation, or any organized group of persons, whether incorporated or not), and make such investigations, as may be necessary or appropriate, in his discretion, to the enforcement or administration of the provisions of this subsection (a).

“(4) For the purpose of obtaining any information, verifying any report required, or making any investigation pursuant to paragraph (3), the President may administer oaths and affirma-

The only attempt to make a crime out of a violation of a ration regulation is a regulation made by the Price Administrator himself. This is contained in General Ration Order No. 8, section 3.1, which reads:

**"Criminal Prosecution.**

**"Any person who wilfully performs any act prohibited, or wilfully fails to perform any act**

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tions, and may require by subpoena or otherwise the attendance and testimony of witnesses and the production of any books or records or any other documentary or physical evidence which may be relevant to the inquiry. Such attendance and testimony of witnesses and the production of such books, records, or other documentary or physical evidence may be required at any designated place from any State, Territory, or other place subject to the jurisdiction of the United States: *Provided*, That the production of a person's books, records, or other documentary evidence shall not be required at any place other than the place where such person resides or transacts business, if, prior to the return date specified in the subpoena issued with respect thereto, such person furnishes the President with a true copy of such books, records, or other documentary evidence (certified by such person under oath to be a true and correct copy) or enters into a stipulation with the President as to the information contained in such books, records, or other documentary evidence. Witnesses shall be paid the same fees and mileage that are paid witnesses in the courts of the United States. No person shall be excused from attending and testifying or from producing any books, records, or other documentary evidence or certified copies thereof or physical evidence in obedience to any such subpoena, or in any action or proceeding which may be instituted under this subsection (a), on the ground that the testimony or evidence, documentary or otherwise, required of him may tend to incriminate him or subject him to a penalty or forfeiture; but no individual shall be subject to prosecution and punishment or to any penalty or forfeiture for or on account of any transaction, matter, or thing concerning which he is compelled to testify or produce evidence, documentary or otherwise, after having claimed his privilege against self-incrimination except that any such individual so testifying shall not be exempt from prosecution and punishment for perjury committed in so testifying. The President shall not publish or disclose any information obtained under the paragraph which the President deems confidential or with reference to which a request for confidential treatment is made by the person furnishing such information, unless the President determines that the withholding thereof is contrary to the interest of the national defense and security; and anyone violating this provision shall be guilty of a felony

required, by any ration order, shall be fined not more than \$1,000, or imprisoned for not more than one year, or both, and shall be subject to such other penalties as may be prescribed by law."

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and upon conviction thereof shall be fined not exceeding \$1,000, or be imprisoned not exceeding two years, or both.

"(5) Any person who willfully performs any act prohibited, or willfully fails to perform any act required by, any provision of this subsection (a) or any rule, regulation, or order thereunder, whether heretofore or hereafter issued, shall be guilty of a misdemeanor, and shall, upon conviction, be fined not more than \$10,000 or imprisoned for not more than one year, or both.

"(6) The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States and the courts of the Philippine Islands shall have jurisdiction of violations of this subsection (a) or any rule, regulation, or order or subpoena thereunder, whether heretofore or hereafter issued, and of all civil actions under this subsection (a) to enforce any liability or duty created by, or to enjoin any violation of, this subsection (a) or any rule, regulation, order, or subpoena thereunder whether heretofore or hereafter issued. Any criminal proceeding on account of any such violation may be brought in any district in which any act, failure to act, or transaction constituting the violation occurred. Any such civil action may be brought in any such district or in the district in which the defendant resides or transacts business. Process in such cases, criminal or civil, may be served in any district wherein the defendant resides or transacts business or wherever the defendant may be found; and subpoena for witnesses who are required to attend a court in any district in any such case may run into any other district. No costs shall be assessed against the United States in any proceeding under this subsection (a).

"(7) No person shall be held liable for damages or penalties for any default under any contract or order which shall result directly or indirectly from compliance with this subsection (a) or any rule, regulation, or order issued thereunder, notwithstanding that any such rule, regulation, or order shall thereafter be declared by judicial or other competent authority to be invalid.

"(8) The President may exercise any power, authority, or discretion conferred on him by this subsection (a), through such department, agency, or officer of the Government as he may direct and in conformity with any rules or regulations which he may prescribe."

That the Price Administrator cannot create or define or prescribe the punishment for crimes, is a proposition too clear to require argument. **The power to enact criminal statutes rests in Congress alone.** The creation of crimes by executive fiat or decree is abhorrent to every concept of Anglo-Saxon jurisprudence. It was never claimed by the most tyrannical king of the Plantagenet or Tudor or Stuart dynasty. It is exclusively within the legislative power to define and declare public offenses and to prescribe the punishment therefor. Crimes against the United States can only be declared and punished by act of Congress. It is beyond the power of executive or administrative officers or bodies to exercise, question, interfere with, or limit powers conferred on the legislature by the Constitution.

**The power to make laws is a legislative power,** and may not be exercised by executive officers or bodies, either by means of rules, regulations, or orders having the force and effect of legislation, or otherwise. The functions of the executive are limited to the enforcement and execution of the law; and any attempt by an executive or administrative officer to create a crime or prescribe a penalty would be violative of the fundamental constitutional principle, recognized and enforced in all free governments, of the separation of legislative, executive and judicial functions.

16 *C.J.S.* 297, 510;

*U. S. v. Powell*, 95 Fed. (2d) 752;

*Commissioner of Internal Revenue v. Van Vorst*, 59 Fed. (2d) 677;

*Great Lakes Hotel Co. v. Commissioner of Internal Revenue*, 30 Fed. (2d) 1;  
*In re Mellea*, 5 Fed. (2d) 687;  
*Panama Refining Company v. Ryan*, 293 U.S. 388, 55 S. Ct. 241, 79 L. Ed. 446.

In *Commissioner of Internal Revenue v. Van Vorst*, 59 Fed. (2d) 677, *supra*, this Honorable Court says:

“It is well settled that department regulations may not invade the field of legislation but must be confined to the limits of congressional enactment.”

The opinion cites

*United States v. George*, 228 U.S. 14, 33 S. Ct. 412, 57 L. Ed. 712,

in which it is said:

“Where the charge is of crime it must have a clear legislative basis.”

In sustaining a demurrer to an indictment charging perjury for the filing of a false affidavit, in relation to an entry of public lands, Judge Wellborn of the Southern District of California, in

*United States v. Maid*, 116 Fed. 650,

in a very learned opinion held that to constitute the crime of perjury it was essential that the affidavit should be material and that it should be authorized by a law of the United States. In the course of this opinion it is said:

“There is another aspect of the case, however, which furnishes as strong an argument against plaintiff’s contention as the one just considered, and it is this: a department regulation may have

the force of law in a civil suit to determine property rights, as in *Cosmos Exploration Co. v. Gray Eagle Oil Co.*, 104 Fed. 45, and yet be ineffectual as the basis of a criminal prosecution. \* \* \* The obvious ground of such distinction is that to make an act a criminal offense is essentially an exercise of legislative power, which cannot be delegated, while the prescribing by the President or head of a department, thereunto duly authorized, of a rule, without penal sanctions, to carry into effect what Congress has enacted, although such rule may be as efficacious and binding as though it were a public law, is not a legislative, but ministerial, function."

In the leading case of *United States v. Eaton*, 144 U.S. 677, 12 S. Ct. 764, 36 L. ed. 591, the Supreme Court of the United States says:

"It is well settled that there are no common law offenses against the United States. *United States v. Hudson*, 11 U.S. 7 Cranch, 14 U.S. 32 [3 L. Ed. 259]; *United States v. Coolidge*, 1 Wheat. 14 U.S. 415 [4 L. Ed. 124]; *United States v. Britton*, 108 U.S. 199, 206 [27 L. ed. 698, 700]; *Manchester v. Massachusetts*, 139 U.S. 240, 262, 268 [35 L. Ed. 159, 166], and cases there cited.

It was said by this court in *Morrill v. Jones*, 106 U.S. 466, 467 [27 L. Ed. 267, 268], that the Secretary of the Treasury cannot by his regulations alter or amend a revenue law, and that all he can do is to regulate the mode of proceeding to carry into effect what Congress has enacted. Accordingly, it was held in that case, under section 2505 of the Revised Statutes, which provided that live animals specially imported for breeding purposes



from beyond the seas should be admitted free of duty, upon proof thereof satisfactory to the Secretary of the Treasury and under such regulations as he might prescribe, that he had no authority to prescribe a regulation requiring that, before admitting the animals free, the collector should be satisfied that they were of superior stock, adapted to improving the breed in the United States.

Much more does this principle apply to a case where it is sought substantially to prescribe a criminal offense by the regulation of a department. It is a principle of criminal law that an offense which may be the subject of criminal procedure is an act committed or omitted 'in violation of a public law, either forbidding or commanding it.' 4 Am. & Eng. Enc. Law, 642; 4 Bl. Com. 5.

It would be a very dangerous principle to hold that a thing prescribed by the Commissioner of Internal Revenue, as a needful regulation under the Oleomargarine Act, for carrying it into effect, could be considered as a thing 'required by law' in the carrying on or conducting of the business of a wholesale dealer in oleomargarine, in such manner as to become a criminal offense punishable under section 18 of the Act; particularly when the same Act, in section 5, requires a manufacturer of the article to keep such books and render such returns as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, may, by regulation, require, and does not impose, in that section or elsewhere in the Act, the duty of keeping such books and rendering such returns upon a wholesale dealer in the article.

It is necessary that a sufficient statutory authority should exist for declaring any Act or omission a criminal offense; and we do not think that the statutory authority in the present case is sufficient."

A long line of decisions, both federal and state, reiterates the principle that executive and administrative officers may not declare offenses to be criminal and fix a penalty for their violation.

*U. S. v. Blassingame*, 116 Fed. 654;

*Morrill v. Jones*, 106 U.S. 467, 1 S. Ct. 424, 27 L. ed. 268;

*Hoover v. Salling*, 110 Fed. 47;

*People v. Parks*, 58 Cal. 624;

*Ex parte Cox*, 63 Cal. 21;

*Board of Harbor Commissioners v. Excelsior Redwood Co.*, 88 Cal. 491, 26 P. 375;

*Anzalone v. Metropolitan District*, 257 Mass. 32, 153 N.E. 325;

*State v. Retowski* (Del.), 175 Atl. 325.

In 11 *Am. Jur.* 965, the rule is thus stated:

"The legislature cannot delegate to a board or to an executive officer the power to declare what act shall constitute a criminal offense. \* \* \* Where a statute does not provide that the violation of regulations shall amount to a criminal offense, the regulations themselves are ineffectual to create such offense. There must in all cases be statutory authority for declaring that an act amounts to a crime, and in addition the penalty must be fixed by the legislature itself."

In an annotation to *Panama Refining Co. v. Ryan*, *supra*, in 79 L. ed. at p. 491, it is said:

“However, the legislature cannot delegate to an administrative board the authority to fix the penalty for a violation of orders or regulations which the legislature authorized the board to make. The penalty must be fixed by the legislature itself.”

Cited in support of this statement are:

*Howard v. State*, 154 Ark. 430, 242 S.W. 818;

*State v. Atlantic Coast Line Railroad Co.*, 56 Fla. 617, 47 So. 969;

*Zuber v. So. R. R. Co.*, 9 Ga. App. 539, 71 S.E. 937;

*U. S. v. Breen*, 40 Fed. 402;

*Tuttle v. Wood* (Tex. Civ.), 35 S.W. (2d) 1061.

In *Zuber v. So. R. R. Co.*, *supra*, it is said:

“To say that wrongful or neglectful conduct shall be penalized is such a legislative function as cannot be delegated by the legislature. That this is true as to penalties of a criminal nature will not be questioned, and we believe that the same principle applies where a wrong or neglect is penalized by giving the person against whom the wrong or neglect particularly operates the right to recover punitive damages in a civil action. In other words, it is purely a legislative function to authorize the imposition of punitive liability, whether that liability is to be enforced in a civil or in a criminal action. The legislature may authorize an administrative body or officer to make regulations, and may declare it to be punishable for any person to violate those regulations; but,

unless the legislature itself gives its sanction, at least in general terms, to the imposition of punishment, or of civil redress in the nature of punishment for an act or general class of acts, no merely administrative board can provide for the punishment of that act or class of acts and supply the details of how and when the penalty or punishment shall be imposed."

Moreover, as heretofore shown by reference to and quotation from the pertinent legislation, no act of Congress prescribes any penalty for the violation of any rationing regulation.

It is as necessary that punishment be annexed to the commission of a crime as it is that the crime be exactly defined.

"No legislative enactment makes an act an offense, a crime, a misdemeanor, unless the statute so denominates it or unless punishment for the act is expressly prescribed."

*Mossew v. United States*, 266 Fed. 18;

*United States v. Seibert*, 2 Fed. (2d) 80;

*Holmes v. United States*, 267 Fed. 529.

In the case of *In re Ellsworth*, 165 Cal. 677, 133 P. 272, Justice Henshaw says:

"A description, definition, and denouncement of acts necessary to constitute a crime do not make the commission of such act or acts a crime, unless a punishment be fixed, for punishment is as necessary to constitute a crime as its exact definition."

In the case at bar, Congress has prescribed no penalty for the violation of any ration order, and the sole

attempt to prescribe a penalty is the attempt by the Administrator, who admittedly has no constitutional power to prescribe the punishment for a crime. The case presents an instance of attempted usurpation of power by an official whose office was created to last only through the emergency existing by reason of a state of war, and who, dressed with a little brief authority, imagined himself clothed with unfettered and unbridled power.

- (b) Even if the provision of the Second War Powers Act prescribing a penalty for the violation of preference orders or priorities could by construction be made applicable to ration orders, each of the informations is still fatally defective because of the failure to charge that either of the defendants knew that the ration stamps mentioned therein were counterfeited.

No count of either information contains any allegation that either of the defendants knew that any of the ration stamps therein mentioned were counterfeit. It is always necessary, in an indictment for the possession, passing or uttering counterfeit money, to allege that the accused knew that the same was counterfeit.

*U. S. v. Otey*, 31 Fed. 68;

*State v. Keneston*, 59 N.H. 36;

*Gade v. State*, 6 Ark. 519;

*U. S. v. Provenzano*, 171 Fed. 675;

*State v. Nicholson*, 14 La. Ann. 785.

Guilty knowledge constitutes an essential ingredient of the offense of passing or uttering counterfeit money (no different rule, we submit, should be applied to counterfeit ration stamps), and should be distinctly averred in the indictment.

In the leading case of *United States v. Carll*, 105 U.S. 611, 26 L. ed. 1135, defendant was convicted in the Circuit Court on an indictment which alleged that the defendant at a certain time and place “feloniously, and with intent to defraud the Bank of the Metropolis, which said bank is a corporation organized under the laws of the State of New York, did pass, utter and publish upon and to the said Bank of Metropolis a falsely made, forged, counterfeited and altered obligation and security of the United States” (which was set forth according to its tenor), against the peace, and contrary to the form of the statute. The defendant moved in arrest of judgment for the insufficiency of the indictment, and the case came before the Supreme Court of the United States on a certificate of division in opinion between the Judges of the Circuit Court as to “whether the indictment, setting forth the offense in the language of the statute, without further alleging that the defendant knew the instruments to be false, forged, counterfeited and altered, was sufficient, after verdict, to warrant judgment thereon.” Mr. Justice Gray delivered the following opinion:

“In an indictment upon a statute, it is not sufficient to set forth the offense in the words of the statute, unless those words of themselves fully, directly and expressly, without any uncertainty or ambiguity, set forth all the elements necessary to constitute the offense intended to be punished; and the fact that the statute in question, read in the light of the common law, and of other statutes on the like matter, enables the court to infer the intent of the Legislature does not dispense with the necessity of alleging in the indictment

all the facts necessary to bring the case within that intent. *U. S. v. Cruikshank*, 92 U.S. 542, 23 L. ed. 588; *U. S. v. Simmons*, 96 U.S. 360, 24 L. ed. 819; *Com. v. Clifford*, 8 Cush. 215; *Com. v. Bean*, 11 Cush. 414; *Com. v. Bean*, 14 Gray, 52; *Com. v. Filburn*, 119 Mass. 297.

The language of the statute on which this indictment is founded, includes the case of every person who with intent to defraud utters any forged obligation of the United States. But the offense at which it is aimed is similar to the common law offense of uttering a forged or counterfeit bill. In this case, as in that, knowledge that the instrument is forged and counterfeited is essential to make out the crime; and an uttering, with intent to defraud, of an instrument in fact counterfeit, but supposed by the defendant to be genuine, though within the words of the statute, would not be within its meaning and object.

This indictment, by omitting the allegation, contained in the indictment in *U. S. v. Howell*, 11 Wall. 432 [78 U.S., 20 L. ed. 195], and in all approved precedents, that the defendant knew the instrument which he uttered to be false, forged and counterfeit, fails to charge him with any crime. The omission is of matter of substance, and not a 'defect or imperfection in matter of form only,' within the meaning of section 1025 of the Revised Statutes. By the settled rules of criminal pleading, and the authorities above cited, therefore, the question of the sufficiency of the indictment must be,

**Answered in the negative."**

(c) Each count of each information is fatally defective because it states mere legal conclusions.

The first count of each information alleges that defendant was not then and there a person "by whom said ration documents were acquired in accordance with the provisions of any ration order, or a person or the agent of a person by whom said ration documents were acquired, possessed or controlled as otherwise provided in any ration order".

The second count of each information alleges that the defendant therein named did transfer red meat ration stamps to the party therein named "otherwise than in a way permitted and otherwise than for a purpose permitted by any ration order".

The third count of each information also alleges a transfer "otherwise than in a way permitted and otherwise than for a purpose permitted by any ration order". (Tr. pp. 2, 6.)

The demurrer of the defendant Belluomini challenged the sufficiency of these allegations in each count of the information. (Demurrer of defendant Belluomini, paragraph II, subdivision (c); paragraph IV, subdivision (c); paragraph VI, subdivision (c). Tr., pp. 11, 12, 13, respectively.)

Allegations of this character have been repeatedly held to be mere conclusions of the pleader, which state no facts and tender no issue.

Of the many decisions which hold such a pleading fatally defective, we cite but one, which we deem conclusive because it is a decision of this Honorable



Court. A single paragraph from the opinion of the late Judge Rudkin in *Johnson v. United States*, 294 Fed. 753, 756, will suffice:

“Again, the averment that the plaintiff in error was a person required to register is a naked conclusion of law at best. If he did certain things, or engaged in certain activities, he was required to register as a matter of law; and, if he did none of these things, he was not. As we have already seen, the court below was of opinion that no person can possess narcotics lawfully without registration, and it would be going a long way indeed to presume that the grand jury did not fall into the same error. The question of the sufficiency of a similar indictment was reserved by this court in *Bacigalupi v. U. S. (C.C.A.)* 274 Fed. 367. In *Pendleton v. U. S.*, *supra*, it was held that a like indictment was defective. A contrary ruling seems to have been made without discussion in *Miller v. U. S. (C.C.A.)* 288 Fed. 816. But it would seem upon principle, as well as upon authority, that where a crime can only be committed by a particular class of persons, the indictment should show upon its face that the defendant belonged to that class, by direct averment, not as a mere conclusion of law; for example, it would not be sufficient, in an indictment for illegal voting, to charge that the defendant was not a qualified voter, without setting forth the grounds of disqualification. *Quinn v. State*, 35 Ind. 485, 9 Am. Rep. 754. So in a prosecution for failure to register under the Selective Service Act (Comp. St. secs. 2044a-2044k) we apprehend it would not be sufficient to charge that the defendant was required to register. The indictment

or information should go further, and show that he was one of the particular class mentioned in the statute.

For these reasons, the judgment is reversed, and the cause is remanded to the court below, with instructions to sustain the demurrer."

The information in the case at bar is even more vulnerable than that in the *Johnson* case. It might just as well have charged in general terms that the defendant violated some ration order, because no details of the violation are set forth. To say that the accused acquired or possessed or transferred the stamps "otherwise than in a way permitted and otherwise than for a purpose permitted by any Ration Order", is a bare conclusion, devoid of any facts, and violates the fundamental principle of criminal pleading that an indictment must state the **facts** with sufficient particularity to apprise the defendant of the precise thing with which he is charged, and to enable **the Court**, and **not the pleader** to determine whether the acts charged constitute a crime.

*United States v. Bopp*, 230 Fed. 723, and cases therein cited.

It has been well said that constitutional provisions requiring that the accused be informed by the indictment of the nature and cause of the accusation cannot be qualified or amended by decisions.

*Asgill v. United States*, 60 Fed. (2d) 780.

Consideration of this point, however, is necessary only in the event of an adverse ruling on the other grounds which heretofore we have urged against the validity of the information.

## II.

THE EVIDENCE WAS INSUFFICIENT TO JUSTIFY THE CONVICTION OF EITHER OF THE DEFENDANTS UPON ANY COUNT OF EITHER INFORMATION.

Belluomini's Assignment No. 3,

Ruggiero's Assignment No. 2:

"That the evidence taken and had upon the trial of the said cause was and is insufficient to justify the verdict or order of the court finding this defendant guilty on the said Information, or on any of the several counts thereof;"

Belluomini's Assignment No. 4,

Ruggiero's Assignment No. 3:

"That said District Court erred in denying the motion of defendants to dismiss;"

Belluomini's Assignment No. 5,

Ruggiero's Assignment No. 4:

"That said District Court erred in ruling that the evidence was sufficient to justify a conviction upon all or any of the counts in the said Information."

All that has been said with reference to the failure of the indictment to charge a crime may be repeated as to the failure of the evidence to prove the commission of a crime.

The testimony shows that the defendants did something that it was not a crime against the United States to do, and fails to show that either of them knew that the ration stamps mentioned in either Information were counterfeit.

In addition to the authorities heretofore cited, we call attention to

*Gallagher v. United States*, 144 Fed. 87,  
in which it is held that in a prosecution for passing false or forged national bank notes, knowledge that they were falsely made is an essential element of the offense and there must be some evidence of such knowledge, circumstantial or otherwise, aside from proof of the naked fact that the spurious note was passed.

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### CONCLUSION.

It is submitted that neither of the Informations charges either of the appellants with any crime, and that none of the acts that the defendants are charged with doing constitutes any crime against the United States, and that accordingly the several judgments appealed from should be reversed and the causes remanded to the District Court with directions to sustain the demurrer of appellant Belluomini and to dismiss and set aside the respective Informations and to discharge each of the appellants without delay.

Dated, San Francisco, California,

April 15, 1946.

WILLIAM E. FERRITER,  
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*Amerigo Belluomini.*

WALTER H. DUANE,  
*Attorney for Appellant,*  
*Edgar Ruggiero.*

No. 11,165

IN THE  
**United States Circuit Court of Appeals**  
**For the Ninth Circuit**

---

EDGAR RUGGIERO and AMERIGO BELLUOMINI,  
*Appellants,*

vs.

UNITED STATES OF AMERICA,  
*Appellee.*

---

**BRIEF FOR APPELLEE.**

---

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No. 11,165

IN THE

# United States Circuit Court of Appeals

For the Ninth Circuit

---

EDGAR RUGGIERO and AMERIGO BELLUOMINI, <i>Appellants,</i>
--

vs.

UNITED STATES OF AMERICA, <i>Appellee.</i>
---

## BRIEF FOR APPELLEE.

---

The appellants Edgar Ruggiero and Amerigo Belluomini were tried without jury before the United States District Court for the Northern District of California upon informations charging them with the unlawful acquisition, possession and control of certain forged and counterfeited red meat ration stamps. Copies of the informations are set forth at page 2 and page 6 of the transcript of record. The appellants were adjudged guilty on all counts and appealed from the judgment of the Court below.

**STATEMENT OF FACTS.**

The facts are substantially those set forth in the opening brief for appellants, at pages 10 to 20, inclusive. In brief, however, they are the following:

Early in May of 1945, the appellant Ruggiero, manager of the Tunnel Market, San Francisco, California, purchased 8700 counterfeited and forged ration stamps, which stamps had a ration point value of 87,000, for a price of \$1820.00. After he received the stamps he turned 5000 of them over to the appellant Belluomini, who was associated with him in another retail meat market business, and deposited the remaining 3700 in his ration bank account at the West Portal Branch of the Bank of America, San Francisco, California. The appellant Belluomini, who operated a retail butcher shop at 37th Avenue and Balboa Street, San Francisco, California, transferred 2500 stamps, having a 25,000 ration point value, to one Leo Massaglia, an employee at his retail butcher shop, who usually prepared his ration currency deposit slips. These stamps were in fact deposited at the Bank of America in the 3700 block of Balboa Street, in San Francisco. The appellant Belluomini later directed his employee Massaglia to destroy the remaining 2500 counterfeited and forged ration stamps. There is no evidence in the record that either appellant was told of the counterfeit nature of these documents.

### ARGUMENT.

ALL OF THE CONTENTIONS STATED BY APPELLANTS UNDER I OF THEIR BRIEF HAVE BEEN SETTLED ADVERSELY TO THE APPELLANTS BY THE DECISIONS OF THE SUPREME COURT AND THE CIRCUIT COURTS OF APPEALS.

- (a) The statutory basis for the authority to ration is found in Section 301 of Title III of the Second War Powers Act set forth in the footnotes at pages 30-33 of the appellant's brief.

The pertinent language of that section is as follows:

“(a)(2) \* \* \* Whenever the President is satisfied that the fulfillment of requirements for the defense of the United States will result in a shortage in the supply of any material or of any facilities for defense or for private account or for export, the President may allocate such material or facilities in such manner, upon such conditions and to such extent as he shall deem necessary or appropriate in the public interest and to promote the national defense.

\* \* \* \* \*

“(5) Any person who willfully performs any act prohibited, or willfully fails to perform any act required by, any provision of this subsection (a) or any rule, regulation, or order thereunder, whether heretofore or hereafter issued, shall be guilty of a misdemeanor, and shall, upon conviction, be fined not more than \$10,000 or imprisoned for not more than one year, or both.

\* \* \* \* \*

“(8) The President may exercise any power, authority, or discretion conferred on him by this subsection (a), through such department, agency, or officer of the Government as he may direct and in conformity with any rules or regulations which he may prescribe.”

The contention of the appellant that "any material" must be held to exclude food is somewhat difficult to understand. The statement in appellant's brief at page 31 that "Congress only made it a crime to violate the provisions of the Section relating to contracts for the building of warships and planes and priorities and allocations thereof" is simply not borne out by the very text of the section printed at pages 30-33 of the appellant's brief, and needs no further discussion.

This Court has only recently recognized the validity of Ration Order No. 8 in a civil case in which it held that the Administrator was entitled to an injunction against *sales of rationed meats without obtaining point values*. *Bowles v. Quon*, 154 F. (2d) 72.

Criminal convictions for the violation of food rationing orders have been sustained in *Coleman v. United States*, 153 F. (2d) 400 (C.C.A. 6) (meat ration points), and *United States v. Schnoll*, 142 F. (2d) 704 (C.C.A. 7) (ration points for canned goods).

The constitutionality of the machinery set up by the Act, the Executive Orders, and orders for rationing materials generally was upheld by the Supreme Court in *L. P. Steuart v. Bowles*, 322 U. S. 398, 64 S. Ct. 1097, and the constitutionality of Ration Order No. 16, relating to dealers in industrial foods, was upheld by a three-judge court in *Walter Brown and Sons v. Bowles*, 58 F. Supp. 323.

In numerous other cases the courts have upheld the Administrator's right to suspend license of food

dealers for violation of food rationing orders. Among such cases are:

*Bowles v. Lee's Ice Cream, Inc.*, 148 F. (2d)

113 (C.A.D.C.) (restaurant case);

*Country Garden Market v. Bowles*, 141 F. (2d)

540 (C.A.D.C.), cert. den. 64 S. Ct. 1264

(Food Ration Order No. 16);

*Gallagher Steak House v. Bowles*, 142 F. (2d)

530 (C.C.A. 2), cert. den. 64 S. Ct. 1288

(restaurant case).

Appellant's contention that Congress could not validly impose criminal liability for a violation of a regulation or order of the Administrator has been settled adversely to the appellant by the decision of the Supreme Court in *Kraus Bros. v. United States*, 66 S. Ct. 705. We quote footnote 4 from the opinion of the Supreme Court:

"4. Section 205(b) is somewhat inartistically drawn. It does not specifically impose criminal liability on those who violate the regulations and orders of the Administrator. But the hurdle of *United States v. Eaton*, 144 U.S. 677, is cleared by the reference in Section 205(b) to Section 4, which makes it unlawful, among other things, to sell or deliver any commodity in violation of any regulation or order. See *In re Kollock*, 165 U.S. 526; *United States v. Grimaud*, 220 U.S. 506; *United States v. George*, 228 U.S. 14; *Singer v. United States*, 323 U.S. 338. Congress has subsequently emphasized this reference even more clearly when in adding Section 204(e)(1) to the Emergency Price Control Act, it spoke of a criminal proceeding 'brought pursuant to section 205

involving alleged violation of any provision of any regulation or order issued under section 2.' Section 107(b), Stabilization Extension Act of 1944, 58 Stat. 639. See also Section 6, Act of June 30, 1945, Public Law 108, amending Section 204(e)(1) of the Emergency Price Control Act."

In *Randall v. United States*, 148 F. (2d) 234 (C.C.A. 5), cert. den. 65 S. Ct. 1579, the Court upheld a criminal conviction for dealing in gasoline ration coupons, stating:

"The Congress acted within constitutional bounds when it delegated the power to fix and define crimes and penalties for crimes, as provided in the Act here under consideration. Such legislation was not an unauthorized delegation of legislative power. *Shreveport Engraving Co. v. United States*, 5 Cir., 143 F. 2d 222, certiorari denied, 65 S. Ct. 82; *United States v. Randall*, 2 Cir., 140 F. 2d 70; *O'Neal v. United States*, 6 Cir., 140 F. 2d 908; 151 A.L.R. 1474; *Gallagher's Steak House v. Bowles*, 2 Cir., 142 F. 2d 530; *Hirabayashi v. United States*, 320 U. S. 81, 63 S. Ct. 1375, 88 L. Ed. 1774; *Fred Toyosaburo Korematsu v. United States*, 323 U. S. 214, 65 S. Ct. 193."

- (b) **The contention of the appellants that the informations are defective because of the failure to charge knowledge that the ration stamps were counterfeit, is without merit.**

The informations were predicated on Sections 2.5 and 2.6 of General Ration Order No. 8, which provide:

"Sec. 2.5. No person shall acquire, use, permit the use of, transfer, possess or control any counterfeited or forged ration document under circum-



stances which would be in violation of Section 2.6 if the document were genuine or if he knows or has reason to believe that it is counterfeited or forged.”

“Sec. 2.6. Acquisition, use, transfer or possession of ration document. No person shall acquire, use, permit the use of, possess or control a ration document except the person, or the agent of the person, to whom such ration document was issued, or by whom it was acquired in accordance with a ration order or except as otherwise provided by a ration order. No person shall use or transfer a token or other ration document except in a way and for a purpose permitted by a ration order.”

Exactly the same contention was made in *United States v. Tobin*, 149 F. (2d) 534, cert. den., 66 S. Ct. 46. The Court said (at page 536):

“We are clearly of the opinion, however, that it was not necessary for the government to allege or prove such knowledge under the circumstances of the instant case. The fallacy of defendant’s contention lies in his failure to recognize that Sec. 2.5 is directed at two distinct situations: (1) where the counterfeited or forged coupons are possessed or transferred under circumstances which would be a violation of Sec. 2.6 if they were genuine, and (2) where such coupons are possessed or transferred with knowledge or reason to believe that they are counterfeited or forged.

“The charge was predicated upon the first situation. Proof of knowledge was therefore unnecessary. Obviously, Sec. 2.6 is directed at the possession and use of genuine coupons acquired in a

manner other than as provided by regulation. Evidently it does not relate to counterfeited or forged coupons. This is the purpose of Sec. 2.5, and under the first situation described in this section it is a violation if such coupons are acquired under circumstances which would be a violation of Sec. 2.6 if they were genuine. In other words, the use or possession of such coupons under such circumstances is unlawful, irrespective of any knowledge as to their spurious character."

- (c) **The informations were sufficient in stating that the defendants had not acquired the ration documents in accordance with the provisions of any ration order and had transferred them otherwise than in a way permitted or for a purpose permitted by any ration order.**

In practically every criminal conviction for the violation of ration orders the informations were couched in the same or similar language. See particularly *Randall v. United States*, 148 F. (2d) 234 (C.C.A. 5), cert. den. 65 S. Ct. 1579, and *United States v. Tobin*, 149 F. (2d) 534 (C.C.A. 7), cert. den. 66 S. Ct. 46.

- (d) **The evidence was sufficient to justify the conviction.**

The only particular in which the appellants claim a lack of evidence to justify a conviction was the lack of knowledge on the part of the appellants that the ration stamps mentioned in either information were counterfeit. (Appellants' Opening Brief, pages 47, 48.) This argument regarding a proposed deficiency in proof is completely answered under the authority of *United States v. Tobin*, *supra*.

**CONCLUSION.**

It is respectfully submitted that the informations are sufficient to sustain the conviction, that the lower Court committed no error, and that the judgment should be affirmed.

Dated, San Francisco, California,  
June 5, 1946.

Respectfully submitted,

FRANK J. HENNESSY,  
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REYNOLD H. COLVIN,  
Assistant United States Attorney,

*Attorneys for Appellee.*

**(Supplement Follows.)**



## **Supplement.**



## Supplement

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### REVISED RATION ORDER 16.

#### *Part 1407, Rationing of Food and Food Products:*

“Sec. 2.3. *How points are given up by a consumer—*

(a) *A consumer uses stamps.* A consumer gives up points, when he acquires foods covered by this order, by surrendering red ‘stamps’ from his War Ration Book Four.

“(b) *Stamps may be used only during certain periods.* Each stamp in War Ration Book Four is good only during a certain period, and a consumer may use it only during that period. The combination of letter and number printed on the stamps serves to indicate the time when the stamp may be used by consumers. The periods during which stamps in War Ration Book Four may be used will be fixed in a supplement to this order. (Transfers of ‘meat’ by farm slaughterers to consumers, covered in section 3.2, are excepted from this rule.)

“(c) *General rules for the use of stamps by consumers.* A consumer must give up stamps worth exactly the point value of the foods covered by this order which he acquires, except that fractional amounts are to be handled in the way described in section 10.6. Red stamps in War Ration Book Four are worth 10 points each, regardless of the number printed on them. Stamps must be given up at the time the foods are acquired. The stamps may be used by a consumer only if torn out of the war ration book in the presence of the person who is selling or trans-

ferring the foods. A stamp may be used only to get foods covered by this order for the consumer from whose book it is taken, or for use at a table at which he eats.

“(d) *A consumer also uses certificates and ration coupons.* Any consumer to whom a ‘board’ issues a ‘certificate’ or ration coupon may use it to acquire foods covered by the order, just as stamps are used. However, a consumer may give up the certificate or ration coupon at or before the time when the foods are acquired. The number of points a certificate or ration coupon is worth is shown on that certificate or ration coupon. A consumer to whom a certificate has been issued must sign his name on the back before he may use it.”

“Sec. 10.1. *Only retailers, wholesalers, and primary distributors may transfer foods covered by this order.* (a) Beginning March 29, 1943, only ‘retailers,’ ‘wholesalers,’ and ‘primary distributors’ may sell or ‘transfer’ ‘foods covered by this order.’ (Certain transactions between ‘consumers,’ covered in section 2.2 are excepted from this rule. Certain other exceptions are covered in Article III and Article XI.)”

“Sec. 10.3. *Transfers to retailers, wholesalers and primary distributors after April 10, 1943 may be made only for points.* (a) Beginning April 11, 1943, no person may sell or transfer foods covered by this order to a retailer, wholesaler, or primary distributor, and no retailer, wholesaler or primary distributor may buy or acquire those foods, unless points are given up in the way this order requires. (The word



'transfer', as it is defined, means to sell, as well as to transfer in other ways. The word 'acquire' means to buy, as well as to get in other ways. Therefore, the only words which will generally be used, in later sections, are 'transfer' and 'acquire'.)

"The rules covering various kinds of transactions are set forth in the sections which follow."

"Sec. 10.4. *How foods covered by this order are transferred to consumers*—(a) *General*. Foods covered by this order may be transferred to a consumer, and may be acquired by him, only if he gives up to the seller or transferor, points exactly equal to the point value of the food transferred, except that fractional amounts are to be handled in the way described in section 10.6. (Certain transactions between consumers covered in section 2.2 are excepted from this rule. Certain other exceptions are covered in Article III and Article XI.) If the consumer is unable to give up points exactly equal to the point value of the foods acquired by him because he does not have 'stamps,' certificates, ration coupons, or ration checks of sufficiently small value to make up the proper amount, he may give up, and the transferor may accept stamps, certificates, ration coupons, or ration checks of the nearest higher value and the transferor must return the excess points to the consumer in the form of tokens."

"Sec. 10.8. *Transferor may not use points he receives in advance until foods are transferred*. (a) A transferor may receive points from his transferee before he actually transfers the foods covered by this

order. In that case, he may not use points so received, to get other such foods, until he has actually transferred to the transferee foods worth that number of points."

"Sec. 16.8. *How ration coupons are issued*—(a) *General.* Whenever a district office, or the Washington Office of the Office of Price Administration, or any other person, is authorized to issue one or more certificates or checks to any person, it shall, unless otherwise directed by the Office of Price Administration, issue ration coupons instead, if he is not entitled to have a ration bank account, or whose ration bank account has been closed under section 9.6 of this order. However, ration coupons may be issued to an industrial consumer whether or not he has a ration bank account and to a retailer who does not have, and is not required to have, a ration bank account.

\* \* \* \* \*

"(b) *How ration coupons are issued and used.* Ration coupons are coupons designated 'ration coupons' which are issued in denominations of 1, 5, 20, 100 and 1,000 points by the Office of Price Administration. Red ration coupons may be used for the acquisition of all foods covered by this order. They need not be endorsed, and are good at any time. In all other respects they may be used in the same way as 'stamps', certificates and ration checks. However, a person who does not have and is not required to have a ration bank account may use ration coupons to give change to any person other than a consumer, but he may use for this purpose only ration coupons having

denominations of 1, 5, or 20 points. (This does not affect the rule that a person who has or is required to have a ration bank account may give up or return points only in the form of a check. The only exception to that rule is in the use of tokens to give change to consumers.)”

“Sec. 20.1. *Additional prohibitions.* \* \* \*

“(d) No person may transfer foods covered by this order for a stamp, token, certificate or ration check if he knows or has reason to believe that it is not valid or that the person tendering it is not entitled to use it.”



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EDGAR RUGGIERO,

VS.

*Appellant,*

UNITED STATES OF AMERICA,

*Appellee.*

APPELLANTS' REPLY BRIEF.

---

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FILED

JUN 17 1946

PAUL P. O'BRIEN,  
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## APPELLANTS' REPLY BRIEF.

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The brief filed by appellee is entirely devoted to answering arguments that appellants **never made** and ignoring those which appellants **did make**. Both the time and the space allotted by the rules of this honorable Court for appellants to reply are extremely brief; but they are both amply sufficient in which completely, decisively, conclusively and finally to refute and dispose of every contention made by the Government.

## I.

APPELLEE MAKES NO ATTEMPT TO ANSWER THE ARGUMENT OF APPELLANTS THAT THE VIOLATION OF A RATIONING ORDER IS NO CRIME, BECAUSE CONGRESS HAS PRESCRIBED NO PENALTY FOR SUCH VIOLATION.

We made it sufficiently clear, we think, in our Opening Brief, that the alleged crime of which these defendants have been convicted was not created by Congress but by the Price Administrator himself. (See Appellants' Opening Brief, pp. 22-23.) We there set forth the history of war powers legislation, quoting the pertinent provisions of the statutes and the executive and administrative orders *in haec verba*.

It must be borne in mind that we are here dealing with a case where men are being subjected to punishment for crime, and that there must be a clear legislative basis to support a charge of crime.

*U. S. v. George*, 228 U. S. 14, 33 S. Ct. 411, 57 L.ed. 712.

Crimes cannot be created by intendment, inference, or presumption,

"Crimes are not to be built up by courts with the aid of inference, implication and strained interpretation, and penal statutes must be construed to reach no further than their words; no person can be made subject to them by implication."

*People v. Zimbrott*, 35 Cal. App. (2d) 745, 91 Pac. (2d) 252;

*Ex parte Twing*, 188 Cal. 261, 204 Pac. 1082.

"Constructive crimes—crimes built up by Courts with the aid of inference, implication and

strained interpretation—are repugnant to the spirit and letter of English and American criminal law.”

*Ex parte McNulty*, 77 Cal. 164, 168, 19 Pac. 237.

That there is no legislative basis for the prosecution of appellants in the case at bar is shown beyond all cavil in our opening brief. The matters there presented in that behalf may be summarized as follows:

The Congress of the United States **never passed any act** specifically authorizing the President of the United States, or any person deputized by him, to **ration food**. No such power was conferred upon the Price Administrator by the **Emergency Price Control Act of 1942** which, with all of its plenteous delegation of powers, only authorizes the Price Administrator to fix maximum rents for housing accommodations and maximum prices that may be charged for commodities. The act gives him no power to say what **quantity** of any commodity may be sold or purchased. This statement, made in our opening brief (p. 22), is not denied by counsel for the Government.

The powers of the Price Administrator in the matter of the rationing of food **rest upon no statute** at all, but upon an **executive order** or proclamation issued by the President of the United States (Executive Order 9280), which is set forth at page 27 of Appellants' Opening Brief.

This order bears date of December 5, 1942. Prior to that date Congress, on December 18, 1941, had passed

what is commonly known as the First War Powers Act (U.S.C.A. Title 50, appendix, Sec. 601-622), and, on March 27, 1942, the so-called Second War Powers Act, the pertinent portion of which is printed in its entirety in a footnote in appellant's opening brief. (pp. 30-33.) The First War Powers Act authorizes the President to redistribute the functions of governmental executive agencies "for the more efficient exercise and more efficient administration by the President of his powers as Commander-in-Chief of the Army and Navy." **The First War Powers Act is not a penal statute**, but is an emergency grant of power to the President, and contains the proviso that the authority granted "shall be exercised only in matters relating to the conduct of the present war." The Second War Powers Act contains but one penal provision; to-wit, that which is set forth in section a(1) of the Act, paragraph 5. The most casual reading of this section should demonstrate to any lawyer having the most elementary knowledge of the rules of statutory construction, and, indeed, to any intelligent layman, that the section deals in its entirety with contracts and allocations "**for the acquisition, construction, repair, or alteration of complete naval vessels or aircraft or any part thereof, etc.**" Tucked away, as it were, in paragraph 2 of the Act is the following language, quoted at page 3 of the Brief for Appellee:

"Whenever the President is satisfied that the fulfillment of requirements for the defense of the

United States will result in a shortage in the supply of any material or of any facilities for defense or for private account or for export, the President may allocate such material or facilities in such manner, upon such condititons and to such extent as he shall deem necessary or appropriate in the public interest and to promote the national defense."

How it could be contended by any lawyer who valued his reputation for sanity that this language refers to anything else than defense **materials**, or that it has any reference whatsoever to **food**, **beggars** our comprehension. It is an elementary rule of law, generally understood by the Courts and members of the profession, that a statute must be read and considered **as a whole**, in order that the true legislative intent may be determined.

The section of the statute quoted by counsel for the Government **does not mention food**. The two words used, each being used twice, are "**material**" and "**facilities**." Certainly, to the mind of the ordinary person of common understanding, a statute dealing with **material** and **facilities** is **not** a statute dealing with **food**, in the absence of some language that would express such an intention on the part of the legislative body. We submit, therefore, that this Court is bound to apply the rule of *noscitur a sociis*, which should be invoked where there is a doubt as to the meaning of a word or expression used by the legislative body in enacting a statute. The color and con-

tent of the doubtful words of a statute are governed by the setting or the associated words.

*First National Bank and Trust Co. v. Beach*,  
301 U. S. 435;

*Russell Motor Car Co. v. United States*, 261  
U. S. 514, 43 S. Ct. 428, 67 L.ed. 788;

*Neal v. Clark*, 95 U. S. 704, 24 L.ed. 586;

*United States v. Baumgartner*, 259 Fed. 722.

It has been held by this Court that in construing a statute, the Court must ascertain the legislative intent, not by taking the word or clause in question from its setting and viewing it apart, but by considering it in connection with its context, the general purposes of the statute, the occasion and circumstances of its use, and other appropriate tests for the ascertainment of the legislative will.

*Carter v. Liquid Carbonic Pacific Corpn.*, 97  
Fed. (2d) 1.

Applying this doctrine and looking to the context of section A of the Second War Powers Act, we find that section primarily authorizes the **Secretary of the Navy**, "to **negotiate contracts** for the acquisition, construction, repair or alteration of complete naval vessels or aircraft or any portion thereof." Divers provisions are contained with reference to such contracts, and a prior statute which provides conditions for purchases of supplies and the making of contracts by the United States, enacted June 30, 1936, is referred to. Paragraph 2 deals with deliveries of material under contracts or orders of the Army or Navy.

Immediately thereafter follows the quoted language upon which counsel for the Government relies. Certainly if this paragraph is to be known from its associates, it has no reference whatsoever to the rationing of the food supply of the nation; and *ex necessitate* the penal provisions contained in paragraph 5 of the section have no reference whatever to the violation of orders rationing food. These orders, as heretofore shown, and indeed the whole subject of food rationing, are not provided for by **any** statute, but the power claimed was one assumed by the President of the United States on the assumption that he possessed that power under the Constitution and laws of the United States as Commander-in-Chief of the armed forces. It is significant that the presidential proclamation makes no mention of either of the war powers acts. All this was pointed out in the opening brief of appellants, and counsel for the Government are compelled to rely upon the penal provisions of paragraph 5 of section A of Title III of the Second War Powers Act alone. It is the mere *ipse dixit* of counsel that this penalty applies to cases of food rationing, and they fail to point out any other penal statute which makes it a crime to violate a rationing order, for the good and sufficient reason that **no such statute exists.**

## II.

NO FEDERAL COURT HAS EVER HELD ADVERSELY TO THE CONTENTION OF APPELLANTS THAT CONGRESS HAS FIXED NO PENALTY FOR DISOBEDIENCE OF A RATIONING ORDER.

A number of decisions are cited by counsel for the Government, but none of them passes upon the question here involved. Most of them are not even remotely in point. We shall deal with them in the order set forth in the brief of appellee.

*Bowles v. Quon*, 154 Fed. (2d) 72, was, as stated by counsel, a civil case, in which it was ruled that the Administrator was entitled to an injunction against sales of rationed meats without obtaining point values.

*Coleman v. United States*, 153 Fed. (2d) 400, was a prosecution for making false statements in a matter within the jurisdiction of a department or agency of the United States, **and** of violating a ration order. Only one point was urged by the appellant as a ground for the reversal of his conviction, to-wit, that information and documents obtained from him by the Office of Price Administration could not be used against him in a criminal proceeding. The Circuit Court of Appeals for the Sixth Circuit ruled adversely to this contention. The point that Congress never had made the violation of a ration order a crime is not discussed in the opinion, undoubtedly for the reason that it was never raised by counsel or called to the attention of the Court. The point



of the discussion was that the use of defendant's own records to prove his failure to keep proper data did not infringe upon the rule against self-crimination. The point that defendant was not, and could not be, guilty, because Congress had not seen fit to make any of his acts punishable as a crime, was not before the Court, and was not passed upon.

Identical comment may be made on *United States v. Schnoll*, 142 Fed. (2d) 704. The defendant was there charged with selling twenty-four cans of peaches to a woman who acted as an *agent provocateur* for some federal officer, without taking a ration stamp from the purchaser. The defendant made the very plausible defense of entrapment and the equally plausible contention that the evidence was insufficient. We need not comment upon the justice of the decision, because whether just or unjust, it has no bearing on the case at bar. It was not suggested to the Circuit Court of Appeals of the Seventh Circuit that the defendant was charged with something which was not a crime.

We temporarily pass *Steuart v. Bowles*, 322 U. S. 398, 64 S. Ct. 1097, 88 L.ed. 1350, for the reason that we shall presently show that it settles the question here involved *against the Government*.

*Brown and Sons v. Bowles*, 58 Fed. (2d) 322, was a decision in an injunction matter by a *nisi prius* Court.

*Bowles v. Lee's Ice Cream Inc.*, 148 Fed. (2d) 113, *County Garden Market v. Bowles*, 141 Fed. (2d) 540,

and *Gallagher State House v. Bowles*, 142 Fed. (2d) 530, all involved suspension of licenses of food dealers and not criminal prosecutions. After citing these decisions, the United States Attorney says (Brief for Appellee, p. 5):

“Appellant’s contention that Congress could not validly impose criminal liability for a violation of a regulation or order of the Administrator has been settled adversely to the appellant by the decision of the Supreme Court of the United States in *Kraus Bros. v. United States*, 66 S. Ct. 705.”

To this statement there are two answers:

First, appellants did not contend that Congress **could not** validly impose criminal liability; their contention was that Congress **did not** impose criminal liability, for a violation of a ration order.

Second, *Kraus Bros. v. United States*, supra, was a prosecution for violating, not a **ration order**, but a **price order** of the Price Administrator. Congress and not the Administrator has made it a crime to violate a price regulation order. In fixing prices, as heretofore shown, the Administrator acts under the Emergency Price Control Act, penalties for the violation of which are **fixed by Congress**. But when the Administrator made a ration order (this Court knows judicially that the only commodity now rationed is sugar), he acted under the presidential proclamation, assumed to be issued under the authority of the war powers act, **which prescribed no penalty**.

*Randall v. United States*, 148 Fed. (2d) 234, also cited by the United States Attorney, should be wholly disregarded because it contains a statement which is demonstrably at variance with the decision of every other Court which has ever passed upon a similar question of constitutional law. The sentence which we refer to reads:

“The Congress acted within constitutional bounds when it delegated the power to **fix and define crimes and penalties for crimes**, as provided in the act here under construction.”

**This statement is a gigantic error.**

First, if there is a single principle of constitutional law irrevocably settled, it is that **Congress cannot delegate the power to fix and define crimes and penalties for crimes**. It may delegate the power to make **rules and regulations**, and to provide that a violation of such rules and regulations shall be a criminal offense; but Congress, and not the rulemaking officers, must say that the act is criminal; Congress and not the official, must provide the extent of the punishment. If the statement in *Randall v. United States*, is the law, then Congress can confer upon any official, from the President of the United States down to every petty officer, the power to create crimes and misdemeanors and to fix the penalty at anything from the payment of a small fine to death. If such be the law, the doctrine of separation of powers which is the very basis of constitutional government is swept away in one sentence. **But it is not the law.** The Supreme Court of the United States has specifically said that:

**“The legislature cannot delegate to an administrative board the authority to fix the penalty for a violation of orders or regulations which the legislature authorized the board to make. The penalty must be fixed by the legislature itself.”**

*Panama Refining Co. v. Ryan*, 293 U. S. 388,  
55 S. Ct. 241, 79 L.ed. 446.

The statement of *Randall v. United States*, *supra*, must have been wholly inadvertent. In any event, it is a decision of another circuit, which this Court is not bound to follow and certainly should not follow.

The cases cited in *Randall v. United States* certainly contain nothing which lends any support to the language of the Circuit Court of Appeals in the *Randall* case. *Korematsu v. United States*, 323 U. S. 214, 65 S. Ct. 193, and *Hirabayashi v. United States*, 320 U. S. 81, 63 S. Ct. 1375, 88 L.ed. 1774, involved convictions of persons of Japanese descent for violating certain orders made by the Military Commander of the Pacific Coast Area in a time of public peril. The Military Commander did not fix the penalty for violation of his order; the punishment was prescribed by an act of Congress.\* Accordingly, those decisions are not in point.

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\*In the act of March 21, 1942 (56 Stat. 173), it was provided:

“That whoever shall enter, remain in, leave, or commit any act in any military area or military zone prescribed, under the authority of an Executive Order of the President, by the Secretary of War, or by any military commander designated by the Secretary of War, contrary to the restrictions applicable to any such area or zone or contrary to the order of the Secretary of War or any such military commander, shall, if it appears that he knew or should have known of the existence and extent of the restrictions or order and that his act was in violation thereof, be guilty of a

## III.

THE SUPREME COURT OF THE UNITED STATES HAS DEFINITELY HELD THAT A VIOLATION OF A RATION ORDER IS NOT PUNISHABLE AS A CRIME.

In *Steuart v. Bowles*, supra, one of the very cases cited by counsel for the Government, the petitioner brought suit for an injunction to enjoin the Office of Price Administration from enforcing an order suspending a dealer in petroleum products for violating a certain ration order adopted by the Price Administrator. The Supreme Court of the United States held that the District Court had properly dismissed the suit, and that the authority given to allocate "materials" carried with it the power to issue suspension orders against retailers. It is specifically held, however, that the power to prescribe penalties rests with Congress, and that Congress had not prescribed the same. This appears from the following language of Mr. Justice Douglas, who delivered the opinion of the Court:

"We agree that it is for Congress to prescribe the penalties for the laws which it writes. It would transcend both the judicial and the administrative function to make additions to those which Congress has placed behind a statute. *United States v. Two Hundred Barrels of Whiskey*, 95 US 571, 24 L. ed. 491; *Campbell v. Gleno Chemical Co.*, 281 US 599, 74 L. ed. 1063, 50 S. Ct. 412; *Wallace v. Cutten*, 298 US 229, 80 L. ed. 1157, 56 S. Ct. 753, supra. Hence we would have no difficulty in agreeing with petitioner's contention if

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misdemeanor and upon conviction shall be liable to a fine of not to exceed \$5,000 or to imprisonment for not more than one year, or both, for each offense."

the issue were whether a suspension order could be used as a means of punishment of an offender. But that statement of the question is a distortion of the issue presented on this record."

Thus the high court distinctly holds that **violations of ration regulations** may be enforced by **injunctions in civil suits**, or by **suspension of licenses**, but **not by criminal prosecutions**.

Congress has neither made it a crime to violate a ration order nor prescribed any penalty for such violation. The only attempt to make such a violation a crime is an order made by the Administrator himself, a power never before asserted or attempted to be exercised by an administrative officer of any constitutional government. The time has not yet come when a free people living under a bill of rights can be deprived of their life, liberty or property by the decree of a public functionary. To sustain the exercise of such power would be, we submit, a death-blow to all liberty and constitutional rights in the land.

Dated, San Francisco, California,

June 17, 1946.

Respectfully submitted,

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No. 11168

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United States  
Circuit Court of Appeals

For the Ninth Circuit.

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PARROTT & COMPANY, a Corporation,  
Appellant,

vs.

UNITED STATES OF AMERICA,  
Appellee.

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Transcript of Record

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Upon Appeal from the District Court of the United States  
for the Northern District of California,  
Southern Division

FILED

NOV 30 1945

PAUL P. O'BRIEN,  
CLERK





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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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In the United States District Court in and for the  
Southern Division of the Northern District of  
California

No. 24255-G

PARROTT & COMPANY, a corporation,  
Plaintiff,

v.

THE UNITED STATES OF AMERICA,  
Defendant.

### COMPLAINT

This suit is for refund of internal-revenue taxes which have been illegally collected, and is brought under the Tucker Act of 1887, 28 USC 41 (20), and the Judicial Code, 28 USC 762. It is founded upon laws of Congress and upon regulations of an executive department, and arises out of:

(a) Virgin Islands Act of March 3, 1917, section 3, 39 Stat. 1133, 48 USC 1394, relating to internal-revenue taxes upon Virgin Islands products.

(b) Revenue Act of 1941, section 533 (a), 26 USC 1941 supp. 2800 (a) (1), and earlier like statutes, relating to the internal tax upon distilled spirits generally.

(c) Revenue Act of February 24, 1919, section 605, 40 Stat. 1108, 26 USC 2800 (a) (5), relating to rectified spirits.

(d) 26 USC 3254 (g), relating to rectifiers of distilled spirits. [1\*]

(e) Revenue Act of February 24, 1919, section 1304, 40 Stat. 1142, 26 USC 3350 (a), relating to taxes upon Virgin Islands products.

(f) RS 3248, 26 USC 2800 (c), relating to time of attachment of tax on distilled spirits.

(g) Customs regulations of 1923, 1931, and 1937, and other Treasury directives.

(h) Trade Agreement Act of June 12, 1934, 48 Stat. 943, 19 USC 1351.

(i) Trade agreement between the United States and Haiti, effective June 3, 1935, 49 Stat. 3739, TD 47667, article II.

(j) Trade agreement between the United States and the United Kingdom, effective January 1, 1939, 54 Stat. 1897, TD 49753, articles XII and XIV.

For causes of action plaintiff alleges as follows:

## I.

Parrott & Company, the plaintiff above named and hereinafter referred to as "taxpayer," is a corporation organized under the laws of the State of California, with its principal office at 320 California Street, San Francisco.

## II.

Taxpayer brought into the United States from the

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\*Page numbering appearing at foot of page of original certified Transcript of Record

Virgin Islands between December 5, 1938 and November 25, 1941 seven consignments of rum in containers holding each 1 gallon or less; this rum had been made by so-called formulas 2, 3, 4, 5, 6, 7, 10, 11, and 12, and had been first distilled at over 100 proof and later by the addition of water was reduced to less than 100 proof.

### III.

These consignments arrived at the port of San Francisco and were there entered for customs purposes and under the supposed authority of statute (a) *supra*, relating to merchandise coming into the [2] United States from Virgin Islands, taxpayer was required to pay various internal-revenue taxes to the collector of internal revenue in San Francisco through the agency of the collector of customs at the port of San Francisco, as follows:

(a) \$2.25, \$3, or \$4 per gallon, according to the revenue rate in effect at time of payment, under statute (b) *supra*, relating to distilled spirits generally, this tax being exacted on all of aforesaid rum, and as will be hereinafter shown a portion of this taxation was on the basis of the wine gallon and a portion on the lower basis of the proof gallon.

(b) At the rate of 30 cents per proof gallon under statute (c) *supra*, relating to rectified spirits this tax being exacted upon rum made according to formulas 2, 7, 10, 11, and 12, but not upon that made according to formulas 3, 4, 5, and 6.

### IV.

These various transactions are identified by offi-



cial data set forth in an appendix which is attached to this complaint as a part thereof and which contains various details concerning each warehouse entry and subsidiary withdrawal entries, commercial brand, quantity, alcoholic proof, formula number, distilled-spirits tax payments, rectification-tax payments (some items excepted), and refunds claimed.

## V.

Formulas 2, 7, 10, 11, and 12, specified in paragraph III (b) *supra* in reference to rum which was subjected to rectification tax, show that rum to have been produced in the following manner:

Formula 2, White Label: Sugar cane is brought to the sugar mill adjoining the distillery. The cane is ground and the resulting juice is piped to the distillery and placed in the fermenting vats. Sufficient sterilized yeast is added to cause proper fermentation. [3] The fermented beer is distilled in a continuous column still and the resulting distillate is then placed into charred oak barrels for ageing. After the rum has been aged it is withdrawn from the barrels and blended with white rum made from molasses. The blend is Government House Rum White Label, which is filtered and bottled and shipped to the United States under the brand name of Government House Rum White Label.

Formula 7, Gold Label: Molasses is placed in fermenting vats. Sufficient sterilized yeast and water added to cause proper fermentation. The fermented beer is distilled in a continuous column still and the remaining distillate is then placed into oak barrels

for ageing. After this rum has been aged, it is withdrawn from the oak barrels or oak containers and not more than 7/10 of 1 percent of sugar caramel is added to bring a uniform color. The rum is then filtered, bottled, and shipped to the United States under the brand name of Government House Rum Gold Label. Government House Rum Gold Label, therefore, is a naturally fermented and distilled liquor.

Formula 10, Government House Rum Gold Label: In the manufacture of Government House Rum Gold Label molasses is placed in fermenting vats. Sufficient water and sterilized yeast are added to cause proper fermentation. The fermented beer is distilled in a continuous column still at less than 190 degrees proof and the resultant distillate is then placed at over 100 degrees proof into newly charred oak barrels, and into re-used oak barrels, from which all char has been removed, for ageing. After sufficient ageing, rum from the reused cooperage is mixed with rum from the new charred cooperage so as to insure the proper color. This rum is then reduced with distilled water to 86 proof in the bottling storage tanks, allowed to stand for a few days, and is then filtered and bottled. The filtering process merely takes out foreign particles of dirt and sediment and does not in any way alter the rum. The rum is then bottled, labeled and shipped to the United States under the name of Government House Rum Gold Label. Government House Rum Gold Label, therefore, is a naturally fermented, distilled and aged liquor.

Formula 11, Government House Rum White Label: In the manufacture of Government House Rum White Label molasses is placed in the fermenting vats. Sufficient water and sterilized yeast are added to cause proper fermentation. The fermented beer is distilled in a continuous column still at less than 190 degrees proof, and the resulting distillate is then placed at over 100 degrees proof into new charred oak barrels from which all char has been removed for ageing. After sufficient ageing, rum from the reused cooperage is mixed with rum from the new charred cooperage so as to insure the proper color. The aged Government House Rum is then reduced with distilled water to 86 degrees proof in the bottling plant storage tanks and treated with Darco carbon in the proportion of 2.4 pounds Darco carbon per one hundred gallons of rum. After 48 to 72 hours the rum is filtered and bottled. The filtering process merely takes out foreign particles of dirt, sediment, and all the carbon which entered into the rum. The rum is then bottled, labeled, and shipped to the United States under the brand name of Government House Rum White Label.

Formula 12, Government House Rum Gold Label: In the manufacture of Government House Rum Gold Label molasses is placed in the fermenting vats. Sufficient water and sterilized yeast are added to cause proper fermentation. The fermented beer is distilled in a continuous column still at less than 190 degrees proof and the resulting distillate is then placed at over 100 degrees

proof into new charred oak barrels from which all char has been removed for [5] ageing. After sufficient ageing, rum from the reused cooperage is mixed with rum from the new charred cooperage so as to insure the proper color. The aged Government House Rum is then reduced with distilled water to 86 degrees proof in the bottling plant storage tanks and treated with Darco carbon in the proportion of 1.0 pound Darco carbon per one hundred gallons of rum. After 48 to 72 hours the rum is filtered and bottled. The filtering process merely takes out foreign particles of dirt, sediment, and all the carbon which entered into the rum. The rum is then bottled, labeled, and shipped to the United States under the brand name of Government House Rum Gold Label.

## VI.

Under the provisions of the Revenue Act of 1926, section 1112, 44 Stat. 115, 26 USC 3313, a claim officially numbered DS 229893 was on December 3, 1942 filed by taxpayer with the Commissioner of Internal Revenue on Treasury form 843 for refund of portions of the taxes mentioned in paragraph III *supra*, it being contended therein that:

(a) The rum in question was not subject to taxation as rectified spirits under statute (c) *supra*; the refund claimed under this contention being \$563.84.

(b) Products of the Virgin Islands are not subject to taxation as rectified spirits; the refund

claimed under this contention being \$563.84, as in the previous contention.

(c) Aforesaid distilled-spirits tax at the rate of \$2.25, \$3, and \$4 per wine gallon should have been at the rate of \$2, per wine gallon, by virtue of the Trade Agreement Act, item (h) *supra*, and the Haitian Trade Agreement, item (i) *supra*; the refund claimed under this contention being \$9042.48.

(d) Alternatively, if the aforesaid rate of \$2 is not applicable [6] to the rum in question, then the assessed rates of \$2.25, \$3, and \$4 should have been based on the proof gallon instead of the wine gallon; the refund claimed under this contention being \$1517.88.

## VII.

Said claim DS 229893 was denied by the commissioner on September 16, 1943, was thereafter reconsidered on protest of claimant, and on October 6, 1943 was again denied (San Francisco rejection schedule AT: rej. 5062, September 27, 1943).

## VIII.

The involved rum is not subject to rectification tax because the Virgin Islands Act, 48 USC, statute (a) *supra*, provides for articles coming into the United States from those islands only the "internal-revenue taxes which are required to be levied, collected, and paid upon like articles imported from foreign countries," while the rectification tax in question is an internal-revenue tax which is required by 26 USC 2800 (a) (5), statute (c) *supra*,

to be paid only upon articles of domestic manufacture.

### IX.

The involved rum is not subject to the rectification tax specified in 26 USC 2800 (a) (5), statute (c) *supra*, because it is not within the provision therein for “distilled spirits \* \* \* rectified, purified, or refined in such manner, and \* \* \* all mixtures produced in such manner, that the person so rectifying, purifying, refining, or mixing the same is a rectifier within the meaning of section 3254 (g),” 26 USC, statute (d) *supra*.

### X.

The involved rum is not within the provision of said section 3254 (g) for “any spurious, imitation, or compound liquors.”

### XI.

The term “rectifier” as defined in said sections 26 USC 2800 (a) [7] (5) and 3254 (g) refers only to processors operating within the United States, and the involved rum, having been produced in the Virgin Islands, is not subject to any rectification tax.

### XII.

If the taxable status of the rum is to be determined by the provisions of the Revenue Act of 1918, 26 USC 3350 (b), statute (e) *supra*, the “distilled spirits” tax of \$2.25 or \$3 per gallon imposed upon that portion of the rum covered by warehouse entries 964, 4623, 4790, 5307, and 5748 (identified in the appendix), should have been assessed upon

the basis of the proof gallon rather than the wine gallon, because domestic spirits originally produced at more than 100 proof are so taxed, and said section 3350 (b) prescribes for Virgin Islands products "a tax equal to the internal-revenue tax imposed in the United States upon like articles of domestic manufacture."

### XIII.

If the taxable status of the rum is to be determined by the provisions of the Virgin Islands Act, statute (a) *supra*, the "distilled spirits" tax of \$2.25 or \$3 per gallon imposed upon that portion of the rum covered by warehouse entries 964, 4623, 4790, 5307, and 5748 (identified in the appendix), should have been assessed upon the basis of the proof gallon rather than the wine gallon, under the following trade agreement and legislation:

(a) The British Trade Agreement of January 1, 1939, item (j) *supra*, which relates to "rum, in containers holding each one gallon or less" (schedule IV, paragraph 802) and by article XII exempts commodities enumerated in schedule IV "from all other duties, taxes \* \* \* or exactions of any kind, imposed on or in connection with importation, in excess of those imposed on the day of the signature of this Agreement or required to be imposed thereafter under laws [8] of the United States of America in force on the day of signature of this Agreement."

(b) The same agreement, which by article XIV provides that "the provisions of \* \* \* Article XII

of this Agreement shall not prevent the imposition at any time on the importation of any article of a charge equivalent to an internal tax imposed in respect of a like domestic article.”

(c) The Trade Agreement Act, statute (h) supra, which provides that “the proclaimed duties and other import restrictions shall apply to articles the growth, produce or manufacture of all foreign countries.”

(d) The revenue laws of the United States, which by 26 USC 2800 (a) (1) and (c), statutes (b) and (f) supra, require taxation upon the proof-gallon basis for spirits which, like the rum here involved, are first distilled at over 100 proof.

#### XIV.

If the taxable status of the rum is to be determined by provisions of the Virgin Islands Act, 48 USC 1394, statute (a) supra, the “distilled spirits” tax should not exceed \$2 per proof or wine gallon, because:

(a) Section 1394 supra provides that upon articles coming into the United States from Virgin Islands there shall be paid “the rates \* \* \* of internal-revenue taxes which are required to be \* \* \* paid upon like articles imported from foreign countries.”

(a) The Haitian Trade Agreement effective June 3, 1935, item (i) supra, provides by article II that the internal-revenue tax chargeable upon rum



imported in containers of 1 gallon or less shall not exceed the internal-revenue tax then in effect with regard to such merchandise, and on March 28, 1935, the date of said agreement, the internal-revenue tax payable upon imported "distilled spirits" [9] was \$2 per proof or wine gallon as provided by section 600 (a), Revenue Act of 1918 as amended by the Liquor Taxing Act of 1934, 26 USC (1934 edition) 1150 (a) (1).

(c) The Trade Agreement Act of 1934, 19 USC 1351 (a) (2), statute (h) *supra*, provides that proclaimed import restrictions, such as are contained in said Haitian Trade Agreement, "shall apply to articles the growth, produce, or manufacture of all foreign countries."

## XV.

Under a long-continued practice in the internal-revenue and customs services in the Treasury Department, the provisions of said Virgin Islands Act, 48 USC 1394, item (a) *supra*, concerning internal-revenue taxes, should have been applied to the involved rum, rather than the provisions of said Revenue Act of February 24, 1919, 26 USC 3350 (a), statute (e) *supra*, relating to taxes upon Virgin Islands products.

Wherefore plaintiff is justly entitled to recover from defendant above-mentioned sum of \$563.84 plus \$9042.48, totaling \$9606.32, or alternatively said sum of \$563.84 plus \$1517.88, totaling \$2071.72, and accordingly prays judgment against defendant for one or the other of said sums, as the court shall

decide to be legally due, plus costs and interest, and for such other relief as to the court shall seem just.

FRANK L. LAWRENCE

GEORGE R. TUTTLE

Attorneys for Plaintiff

State of California,

City and County of San Francisco—ss.

Frank L. Lawrence, being first duly sworn, deposes and says that he is one of the attorneys for the plaintiff named in the foregoing complaint; that he has read the complaint and knows the contents thereof, and that the facts stated therein are true to the best of his knowledge and belief.

FRANK L. LAWRENCE

Subscribed and sworn to before me this 10th day of January 1945.

[Seal]

H. M. KLISSAMBURU

Notary Public in and for the City and County of San Francisco, State of California.

My commission expires November 20, 1947. [10]

## APPENDIX

Following are data concerning the seven consignments of rum mentioned in paragraphs II and III of attached complaint, including date and official customs number of each warehouse entry and of each entry for withdrawal from warehouse, date of payment of tax upon withdrawal, the commer-

cial brand name, quantity, alcoholic proof, formula number, rectification tax, distilled spirits tax, and refunds claimed; schedule data are to be interpreted thus: "White—2—286—180—2.25" means White Label brand rum, formula 2, 86 proof, 180 wine gallons at 2.25, and columns (a), (b), (c), and (d) show:

(a) Rectification tax at 30 cents per proof gallon, all of which is claimed to be refundable.

(b) Distilled-spirits tax at \$2.25, \$3 or \$4 per wine gallon, part of which is claimed to be refundable.

(c) Refund claimed with distilled-spirits tax reduced to \$2 per wine gallon.

(d) Refund alternatively claimed upon basis of distilled-spirits tax on proof gallon instead of wine gallon:

## (1) Warehouse entry 964, December 5, 1938:

		(a)	(b)	(c)	(d)
4686	12- 8-38	White	2-86-180	-2.25	\$ 46.44
5571	12-23-38	Gold	3-90-240	-2.25	\$ 45.00
829	8- 7-40	White	2-86-88.8	-3.00	60.00
1754	9-12-40	White	2-86-120	-3.00	22.91
3204	10-31-40	White	2-86-120	-3.00	30.96
					30.96

## (2) Warehouse entry 4623, June 3, 1940:

9997	6- 6-40	Gold	7-86-120	-2.25	\$ 30.96
		4 yr.	5-90-120	-2.25	270.00
		White	4-86-60	-2.25	135.00
11199	6-28-40	Gold	7-86-180	-2.25	405.00
		4 yr.	5-90-57.6	-2.25	129.60
1128	8-20-40	4 yr.	5-90-2.4	-3.00	7.20
3702	11-15-40	Gold	7-86-240	-3.00	720.00
4277	12- 4-40	4 yr.	5-90-60	-3.00	180.00
					30.00
					30.00
					15.00
					45.00
					14.40
					2.40
					240.00
					60.00

## (3) Warehouse entry 4790, June 27, 1940:

1047	8-15-40	White	4-86-60	-3.00	\$ 180.00
1129	8-20-40	4 yr.	5-90-120	-3.00	360.00
1423	9- 3-40	4 yr.	5-90-120	-3.00	360.00
5504	1-22-41	Gold	7-86-240	-3.00	720.00
48	7- 2-41	Gold	7-86-60	-3.00	180.00
1007	8-20-41	Gold	7-86-60	-3.00	180.00
1730	9-25-41	Gold	7-86-120	-3.00	360.00
1934	9-29-41	Gold	7-86-60	-3.00	180.00
					60.00
					60.00
					25.20
					25.20
					50.40
					25.20

	(a)	(b)	(c)	(d)
2529	10- 8-40	4 yr.	5-90-240 —3.00	—
3205	10-31-40	4 yr.	5-90-240 —3.00	—
4278	12- 4-40	4 yr.	5-90-120 —3.00	—
(5) Warehouse entry 359, October 9, 1941:				
2207	10-16-41	4 yr	5-90-120 —4.00	\$
2226	10-17-41	4 yr	5-90-120 —4.00	—
2209	10-21-41	4 yr	5-90— 2.2 —4.00	—
2480	11- 3-41	4 yr	5-90-120 —4.00	—
2662	11-13-41	4 yr	5-90-237.6 —4.00	—
3618	1-12-42	Gold	10-86— 60 —4.00	27.46
3669	1-14-42	4 yr	5-90-117.6 —4.00	—
		Gold	10-86— 84 —4.00	27.46

## (6) Warehouse entry 547, November 25, 1941:

3049	12- 3-41	Gold	12-86— 2 —4.00	\$	.52	\$	8.00	\$	4.00	—
		4 yr	5-90— 3.5 —4.00	—	—	—	14.00	—	7.00	—
3121	12- 8-41	4 yr	5-90— 2.4 —4.00	—	—	—	9.60	—	4.80	—
3172	12-11-41	White	11-86-120 —4.00	—	30.96	—	480.00	—	240.00	—
3595	1- 9-42	4 yr	5-90— 57.6 —4.00	—	—	—	230.40	—	115.20	—
3617	1-12-42	4 yr	5-90-120 —4.00	—	—	—	480.00	—	240.00	—
3670	1-14-42	4 yr	5-90-237.6 —4.00	—	—	—	950.40	—	475.20	—
3985	2- 3-42	White	11-86— 84 —4.00	—	21.67	—	336.00	—	168.00	—
		Gold	12-86-120 —4.00	—	30.96	—	480.00	—	240.00	—
4035	2- 6-42	Gold	12-86— 69.6 —4.00	—	17.96	—	278.40	—	139.20	—
5613	6-11-42	4 yr	5-90— 60 —4.00	—	—	—	240.00	—	120.00	—
776	8-19-42	4 yr	5-90— 51.84—4.00	—	—	—	230.40	—	115.20	—

## (7) Warehouse entry 5748, January 22, 1941:

	(a)	(b)	(c)	(d)
5523	1-23-41	4 yr	5-90-396	-3.00
		White	4-86-120	-3.00
		Gold	6-86-24	-3.00
5524	1-23-41	4 yr	5-90-84	-3.00
		White	4-86-120	-3.00
		Gold	6-86-96	-3.00
6344	3-10-41	4 yr	5-90-120	-3.00
6963	4-17-41	4 yr	5-90-120	-3.00
7764	5-2-41	4 yr	5-90-120	-3.00
47	7-2-41	4 yr	5-90-120	-3.00
1731	9-25-41	White	4-86-60	-3.00
1936	9-29-41	White	4-86-60	-3.00
				-----
				*(a)
				-----
				*(b)
				-----
				*(c)
				-----
				*(d)
				-----
*Totals	.....\$563.84	\$19,871.00	\$9,042.48	\$1,517.88

[Endorsed]: Filed Jan. 10, 1945. [12]

[Title of District Court and Cause.]

MOTION TO DISMISS

Comes now the United States of America, defendant herein, by Frank J. Hennessy, United States Attorney in and for the Northern District of California, and moves the Court to dismiss the complaint for the following reasons:

1. The complaint fails to state a cause of action against the defendant, and the plaintiff is not entitled to the relief prayed for.

2. The facts as alleged in the complaint show affirmatively that all taxes, for the refund of which this suit has been brought, were properly and lawfully collected by the defendant from the plaintiff in accordance with the statutes and regulations then existing.

/s/ FRANK J. HENNESSY

United States Attorney

[Endorsed]: Filed Mar. 24, 1945. [13]

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[Title of District Court and Cause.]

ORDER GRANTING MOTION TO DISMISS

The motion of defendant to dismiss plaintiff's complaint is granted.

Dated: July 20, 1945.

LOUIS E. GOODMAN

United States District Judge

[Endorsed]: Filed July 21, 1945. [14]

[Title of District Court and Cause.]

### NOTICE OF APPEAL

To the Clerk, United States District Court:

Notice is hereby given that Parrott & Company, plaintiff above named, hereby appeals to the Circuit Court of Appeals for the Ninth Circuit from the order granting motion to dismiss which was made on July 20, 1945 by Honorable Louis E. Goodman, United States District Judge, of which order notice was given to plaintiff by mail under date of July 23, 1945 by the clerk of this court.

FRANK L. LAWRENCE

GEORGE R. TUTTLE

WALTER I. CARPENETI

Attorneys for Appellant

[Endorsed]: Filed Sept. 4, 1945. [15]

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[Title of District Court and Cause.]

### BOND FOR COSTS ON APPEAL

Whereas plaintiff in above-entitled suit has appealed to the United States Circuit Court of Appeals, Ninth Circuit, from a judgment made and entered against it in said suit:

Now, therefore, we Parrott & Company, a corporation organized and existing under the laws of the state of California, as principal, and Associated Indemnity Corporation, a corporation organized and existing under the laws of state of California, as



surety, are held and firmly bound unto the United States for payment of the sum of two hundred and fifty dollars (\$250), to the payment of which well and truly to be made we bind ourselves jointly and severally by these presents.

The condition of the above obligation is such that, if plaintiff shall prosecute this appeal to effect and shall answer all costs if he fail to make good his plea, then the above obligation to be void, but otherwise to remain in full force and effect.

The undersigned surety agrees that in case of any breach of any condition hereof the court may, upon not less than ten days' notice to the undersigned, proceed summarily to ascertain the amount which the undersigned as surety is bound to pay on account of such breach, and to render judgment against it and award execution therefor, not to exceed the sum specified in this undertaking. [16]

Witness our hands and seals, this 12th day of September, 1945.

(Seal) PARROTT & COMPANY

By R. H. MENZIES,

Pres.

ASSOCIATED INDEMNITY  
CORPORATION

By CHAS. A. PREVOST

Attorney-In-Fact

[Endorsed]: Filed Sept. 13, 1945. [17]

[Title of District Court and Cause.]

DESIGNATION OF CONTENTS OF RECORD  
ON APPEAL

In accordance with number 75 (a), Federal Rules of Civil Procedure, appellant hereby designates the following documents for inclusion in the record on appeal in above-entitled case:

- (1) The complaint.
- (2) Defendant's motion to dismiss.
- (3) Order granting motion to dismiss.
- (4) Notice of appeal.
- (5) Bond for costs on appeal.
- (6) This designation of contents.

San Francisco, September 13, 1945.

FRANK L. LAWRENCE

Attorney for Appellant

Receipt of a copy of above document on this 13th day of September, 1945, is hereby acknowledged.

FRANK J. HENNESSY

United States Attorney

[Endorsed]: Filed Sept. 13, 1945. [18]

[Title of District Court and Cause.]

ORDER EXTENDING TIME TO DOCKET

Good cause appearing therefor,

It Is Hereby Ordered that the Appellant herein may have to and including November 23, 1945, to file the Record on Appeal in the United States Circuit Court of Appeals in and for the Ninth Circuit.

Dated: October 13, 1945.

LOUIS E. GOODMAN

United States District Judge.

[Endorsed]: Filed Oct. 15, 1945. [19]

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District Court of the United States  
Northern District of California

CERTIFICATE OF CLERK TO TRANSCRIPT  
RECORD ON APPEAL

I, C. W. Calbreath, Clerk of the District Court of the United States, for the Northern District of California, do hereby certify that the foregoing 19 pages, numbered from 1 to 19, inclusive, contain a full, true, and correct transcript of the records and proceedings in the case of Parrott & Company, a corporation, Plaintiff, vs. The United States of America, Defendant No. 24255-G, as the same now remain on file and of record in my office.

I further certify that the cost of preparing and certifying the foregoing transcript of record on ap-

peal is the sum of \$3.05 and that the said amount has been paid to me by the Attorney for the appellant herein.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court at San Francisco, California, this 20th day of October, A.D. 1945.

[Seal]

C. W. CALBREATH,  
Clerk

By E. VAN BUREN  
Deputy Clerk [20]

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[Endorsed]: No. 11168. United States Circuit Court of Appeals for the Ninth Circuit. Parrott & Company, a Corporation, Appellant, vs. United States of America, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the Northern District of California, Southern Division.

Filed October 24, 1945.

PAUL P. O'BRIEN,  
Clerk of the United States Circuit Court of Appeals  
for the Ninth Circuit.

In the United States Circuit Court of Appeals for  
the Ninth Circuit

No. 11168

PARROTT & COMPANY, a Corporation,  
Appellant,

vs.

UNITED STATES OF AMERICA,  
Appellee.

### STATEMENT OF POINTS ON APPEAL

For a statement of points on which it intends to rely in this appeal appellant asserts that the court below erred in the following respects:

(1) In granting defendant's motion to dismiss the complaint herein.

(2) In failing to hold that the Virgin Islands Act of 1917, 48 USC 1394, providing the same internal taxes upon merchandise coming into the United States from those Islands as those levied upon "like articles imported from foreign countries," was not superseded by the Revenue Act of 1919, 26 USC 3350 (a), which provides for such merchandise the same taxes as "upon like articles of domestic manufacture."

(3) In failing to hold that a domestic tax of 30 cents per proof gallon, imposed under 26 USC 2800 (a) (5) and known as a "rectification" tax, had been illegally imposed in this case upon rum produced in the Virgin Islands and brought into this country from those Islands.

(4) In failing to hold that the involved rum had not been rectified and had therefore been illegally taxed as such under 26 USC 2800 (a) (5) *supra* and 26 USC 3254 (g) relating to spirits produced by a rectifier.

(5) In failing to hold that the terms "rectification," "rectified," and "rectifier," as used in statutes above cited relate only to processing within the United States and therefore the rectification tax is not applicable to products of the Virgin Islands.

(6) In failing to hold that the rum is not within the provision in section 3254 (g) *supra* for "spurious, imitation, or compound liquors."

(7) In failing to hold that, if the rum is taxable upon the same basis as "like articles imported from foreign countries" as provided in the Virgin Islands Act *supra*, then the "distilled-spirits" tax under 26 USC 2800 (a) (1).

(a) Should have been levied on the basis of the proof gallon rather than the wine gallon, under the British Trade Agreement of January 1, 1939, 54 Stat. 1897, and the Trade Agreement Act of June 12, 1934, 19 USC 1351; or:

(b) Said distilled-spirits tax should have been at the rate of \$2 per wine gallon, under the Haitian Trade Agreement of June 3, 1935, 49 Stat. 3737, and the Trade Agreement Act *supra*.

(8) In failing to hold alternatively that, if the rum is taxable upon the same basis as "like

articles of domestic manufacture" under 26 USC 3350 (a) supra, then the basis of said "distilled-spirits" tax should have been the proof gallon rather than the wine gallon.

(9) In not giving effect to a long-continued administrative construction of the Virgin Islands Act supra under which merchandise from the Islands was taxed at the rates provided for "like articles imported from foreign countries," instead of at the rates provided by 26 USC 3350 (a) supra for "like articles of domestic manufacture."

(10) In refusing plaintiff the right to trial wherein pertinent administrative practice under the Virgin Islands Act and rectification statutes supra and material commercial understanding of the phrase "spurious, imitation, or compound liquors," in 26 USC 3254 (g) supra, would have been established.

San Francisco, November 5, 1945.

FRANK L. LAWRENCE,  
GEORGE R. TUTTLE,  
WALTER I. CARPENETI,  
Attorneys for Appellant.

Receipts of copies of above document this 5th day of November, 1945, is hereby acknowledged.

FRANK J. HENNESSY,  
United States Attorney.

By ALBERT S. GUERARD  
Assistant United States At-  
torney.

[Endorsed]: Filed November 5, 1945. Paul P. O'Brien, Clerk.





No. 11,168

United States  
Circuit Court of Appeals  
For the Ninth Circuit

---

PARROTT & COMPANY, a corporation, *Appellant*

vs.

UNITED STATES OF AMERICA, *Appellee*

---

Upon Appeal from the District Court of the United States for  
the Northern District of California, Southern Division.

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BRIEF FOR APPELLANT

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FRANK L. LAWRENCE

GEORGE R. TUTTLE

*Attorneys for Appellant*

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PARKER PRINTING COMPANY, 545 SANSOME STREET, SAN FRANCISCO

FILED

FEB 1 1946

PAUL P. O'BRIEN,  
CLERK



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No. 11,168

United States  
Circuit Court of Appeals  
For the Ninth Circuit

---

PARROTT & COMPANY, a corporation, *Appellant*

VS.

UNITED STATES OF AMERICA, *Appellee*

---

Upon Appeal from the District Court of the United States for  
the Northern District of California, Southern Division.

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**BRIEF FOR APPELLANT**

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**A) STATEMENT**

1) *Jurisdictional facts*: This appeal relates to an action brought by appellant against appellee, seeking refund of internal-revenue taxes paid by appellant to Clifford C. Anglim and to Richard Nickell, who upon the dates of payment were the collector of internal-revenue and the acting collector of internal-revenue, respectively,

at San Francisco, but neither of whom was the collector of internal-revenue at San Francisco at the time this action was commenced. The taxes were collected by Anglim and Nickell through the agency of the San Francisco collector of customs, and the suit is based upon the Tucker Act of 1887, 28 USC 41 (20).

On July 20, 1945, the United States district judge granted defendant's (appellee's) motion to dismiss, the motion being based upon the contention that the complaint failed to state a cause of action and that the facts alleged in the complaint show affirmatively that said taxes were lawfully collected (R 19). Jurisdiction of this court to review the order of the district court is based upon 28 USC 225(1).

2) *Questions presented*: Following is a statement of the questions presented, and the statutes and trade agreements involved:

The internal-revenue taxes were paid on rum brought into the United States from the Virgin Islands during the years 1938 to 1941 (R 4). The formulae under which this rum was produced are set forth in the complaint (R 5-8). In brief, they show that it was first distilled at over 100 degrees proof, placed in charred oak barrels for aging, removed from the barrels for blending with other rum, or for the addition of small amounts of caramel or carbon (.7 percent caramel, or from 1 to 2.4 pounds of carbon per 100 gallons of rum), filtered, reduced in proof by addition of distilled water, bottled at a proof of 86 degrees, and shipped in that condition to the United States.

As to this rum, three basic contentions are made by appellant, as follows:

a) That a tax of 30 cents per proof gallon, applicable to *rectified* distilled spirits, should not have been collected (R 8).

b) That the "distilled spirits" tax of \$2.25, \$3 or \$4 per gallon (the rate depending upon date of payment) should not have been assessed upon the basis of the wine gallon, but rather upon the basis of the proof gallon (R 9).

c) Alternatively, that said "distilled spirits" tax should have been assessed at the rate of \$2 per wine gallon (R 9).

These contentions are based upon laws, trade agreements, and regulations, principally those set forth in the appendix hereto, as follows:

(a) Virgin Islands Act of March 3, 1917, section 3, 39 Stat. 1133, 48 USC 1394, relating to internal-revenue taxes upon Virgin Islands products.

(b) Revenue Act of 1918, section 1304, 40 Stat. 1142, 26 USC 3350 (a), relating to taxes upon Virgin Islands products.

(c) Revenue Act of 1918, section 605, 40 Stat. 1108 26 USC 2800 (a)(5), relating to rectified spirits.

(d) RS 3244 (3), 26 USC 3254 (g), relating to rectifiers of distilled spirits.

(e) RS 3248, 26 USC 2800 (c), relating to time of attachment of tax on distilled spirits.

(f) Trade Agreement Act of June 12, 1934, 48 Stat. 943, 19 USC 1351.

(g) Trade agreement between the United States and the United Kingdom, effective January 1, 1939, 54 Stat. 1897, TD 49753, articles XII and XIV.

(h) Trade agreement between the United States and Haiti, effective June 3, 1935, 49 Stat. 3737, TD 47667, article II.

(i) 26 C.F.R. 1941 supp. 180.134 (a), relating to internal-revenue tax on Virgin Islands products.

It is appellant's contention that the rectifying tax of 30 cents per proof gallon (26 USC 2800 (a)(5)) was inapplicable because (1) the rum had not been rectified or produced in such manner that the producer was a rectifier within the meaning of 26 USC 3254 (g); (2) that even had it been so produced the tax is inapplicable, because products of the Virgin Islands should be taxed upon arrival in the United States in the same manner as foreign products are taxed (48 USC 1394); namely, without assessment of the rectifying tax.

The first of these two contentions requires determination as to the scope of 26 USC 2800 (a)(5) and 26 USC 3254 (g), and the second requires determination of whether Virgin Islands products are taxable upon their arrival in the United States in accordance with the Virgin Islands Act of March 3, 1917, section 3, 39 Stat. 1133, 48 USC 1394, or in accordance with the Revenue Act of 1918, section 1304, 40 Stat. 1142, 26 USC 3350 (a). With regard to the first point, i.e., the scope of 26 USC 2800 (a)(5) and 26 USC 3254 (g), the question presented is whether the rum, as described in 26 USC 2800 (a)(5) was "rectified, purified, or refined in such manner," or was a mixture "produced in such manner," that the person "so rectifying, purifying, refining, or mixing the same *is a rectifier* within the meaning of section 3254 (g)," also, whether the definition of a rectifier in said section

3254 (g) extends to persons performing the described acts in the Virgin Islands rather than in the United States. Appellant contends that the merchandise was not rectified, etc., and that the producer was not a "rectifier" as thus defined.

The second contention as to the rectifying tax arises out of the fact that the Virgin Islands Act of 1917, 48 USC 1394, provides that products of those islands which come into the United States shall pay "the rates of duty and internal-revenue taxes which are required to be levied, collected, and paid upon like articles *imported from foreign countries*," whereas the Revenue Act of 1919, 26 USC 3350 (a), specifies that Virgin Islands products coming into the United States shall pay "a tax equal to the internal-revenue tax imposed in the United States upon like articles *of domestic manufacture*." Consequently, as rectified foreign spirits are not assessed with the 30 cent tax when imported into the United States, this phase of the appeal requires determination of whether the act of 1917 or the act of 1919 controls.

A distinctly separate issue exists with regard to the internal-revenue tax as distinguished from the rectification tax, plaintiff's contentions being as follows:

a) If the taxable status of this rum is to be determined upon the basis of "like articles of domestic manufacture" as specified in 26 USC 3350 (a) *supra*, then the distilled spirits tax should have been based upon the proof gallon rather than the wine gallon. The rum was created at more than 100 proof, and domestic rum produced in this manner is taxed upon the proof gallon.

Alternatively, appellant seeks the same conclusion if the tax should be the same as that collected upon "like

articles imported from foreign countries” as specified in the 1919 act. In 1939 the amount of internal-revenue tax on foreign rum was “frozen” by the trade agreement between the United States and the United Kingdom, cited above. Consequently the United States is prohibited by that trade agreement from charging a greater amount of internal-revenue tax upon foreign rum than that currently being imposed upon domestic rum; and as domestic rum is taxable upon the basis of the proof gallon, foreign rum should also be on that basis.

The remaining contention that the internal-revenue tax should not have been greater than \$2 per wine gallon is based upon the fact that the trade agreement between the United States and Haiti cited above, which became effective June 3, 1935, enjoined the United States from assessing upon rum imported in containers holding less than one gallon an internal-revenue tax greater than the amount then being assessed, namely, \$2 per gallon. Consequently, if the status of Virgin Islands products is to be determined upon the basis of the 1917 Virgin Islands Act, i.e., as being the same as that imposed upon “like articles imported from foreign countries,” then the taxes assessed here of \$2.25, \$3, or \$4 per gallon were excessive to the extent they exceeded the rate of \$2 in effect in 1935; namely \$2 per gallon.

## **B) ARGUMENT**

### **I) Rectification Tax Inapplicable to Virgin Islands Rum**

1) *Statutes*: Pertinent statutes are set forth below, so far as material; and it may be noted that for revenue purposes, both customs and internal, the term “United

States'' does not include the Virgin Islands (19 USC 1401 (k); 26 USC 3797 (a)(9)). Also at least as far back as acquisition of the Philippines in 1898, as well as Virgin Islands, Guam, and so on, it has been the uniform American legislative policy to keep these possessions outside the taxation system of the country, and for many purposes to give them the same status as foreign countries. For instance, merchandise from the Philippines and Virgin Islands, unless of insular origin, is dutiable at the same rates as though imported from a foreign country (19 USC 1301, 48 USC 1394); and each of these possessions has its own system of import and internal taxation (48 USC 1010, 1395-6). The variety of special legislation concerning these insular entities is revealed by title 48, United States Code.

Basic statutes are as follows:

a) Revenue Act of 1918, section 1304, 40 Stat. 1142, 26 USC 3350 (a):

Sec. 1304. That there shall be levied, collected, and paid in the United States, upon articles coming into the United States from the Virgin Islands, a tax equal to the internal-revenue tax imposed in the United States *upon like articles of domestic manufacture; . . .*

b) Virgin Islands Act of March 3, 1917, section 3, 39 Stat. 1133, 48 USC 1394:

Sec. 3. That on and after the passage of this act there shall be levied, collected, and paid upon all articles coming into the United States or its possessions, from the West Indian Islands ceded to the United States by Denmark, the rates of duty and internal-revenue taxes which are required to be

levied, collected, and paid *upon like articles imported from foreign countries*; . . .

c) Same act, section 5, 48 USC 1396:

Sec. 5. That the duties *and taxes collected in pursuance of this act* shall not be covered into the general fund of the Treasury of the United States, but shall be used and expended for the government and benefit of said islands under such rules and regulations as the President may prescribe.

It should be explained that the 30-cent rectification tax is exacted upon the "articles of *domestic* manufacture" mentioned in section 1304 *supra*, but that under a uniform Treasury practice it has not been collected upon "articles imported from *foreign* countries" (sec. 3 *supra*), which are subjected merely to the basic rate provided for distilled spirits generally, being \$2.25 per gallon under 26 USC 2800 (a)(1), though since raised to \$9. The assessment of rectifying tax in the instant case is made on the theory that Virgin Islands spirits are subject to above-quoted provision for "articles of *domestic* manufacture."

In the court below appellee contended that these two provisions "are clearly in conflict and inconsistent" in regard to Virgin Islands rum, and that the 1918 act, "being the later, is therefore controlling." However, appellant's position is that the statutes do not conflict in regard to the rectification tax. This argument is supported by rules of statutory construction, by evidence of intent intrinsic and obvious in the Virgin Islands law, and by established administrative practice and presumed legislative adoption of that practice.



2) *Rules of construction*: The two sections relate to the same subject and therefore should be considered together, under the familiar rule for statutes *in pari materia*, and should be so construed as to permit both to stand together and remain in effect so far as circumstances permit.

The following decisions by the Supreme Court are among many that might be cited to this subject:

a) *US v. Dotterweich*, 320 US 277, 280: Regard for legislative purposes “should infuse construction.”

b) *Wilmot v. Mudge*, 103 US 217, 221: Here it is said:

The rules of construing statutes in like cases with the present are so well understood as to need no citation of authorities. They are: First, that effect shall be given to all the words of a statute, where this is possible without a conflict; and, second, that, as regards statutes *in pari materia* of different dates, the last shall repeal the first only when there are express terms of repeal, or where the implication of repeal is a necessary one. When repeal by implication is relied on it must be impossible for both provisions under consideration to stand, because one necessarily destroys the other. If both can stand by any reasonable construction, that construction must be adopted.

Here there are no “express terms of repeal,” nor is “the implication of repeal . . . a necessary one.” Also, it is not “impossible for both provisions under consideration to stand,” because the later one does not “necessarily” destroy the earlier one, and “both can stand by . . . reasonable construction.” The construction urged below by appellee would destroy the pertinent portion

of the Virgin Islands Act, whereas appellant's construction would give full effect to that act while only slightly narrowing the effect of the 1918 revenue act.

c) *Southland Gasoline Co. v. Bailey*, 319 US 44, 47: As to another instance of statutes of different periods, the Supreme Court said:

The problem of statutory construction . . . should not be solved simply by a literal reading of the exemption section of the Fair Labor Standards Act and the delegation of power section of the Motor Carriers Act. Both sections are parts of important general statutes and their particular language should be construed in the light of the purposes which led to the enactment of the entire legislation. *United States v. American Trucking Association*, 310 US 534, 542. . . .

It will be demonstrated below that the dominating purpose of the statutes here in question is ascertainable from the Islands act.

d) *Securities & Exchange Comm. v. Joiner Leasing Co.*, 319 US 344, 350: This decision refers to:

. . . the doctrine that courts will construe the details of an act in conformity with its dominating general purpose, will read text in the light of context and will interpret the text so far as the meaning of the words fairly permits, so as to carry out in particular cases the generally expressed legislative policy.

The instant case is especially within the rule, because as noted *infra* the legislative policy is expressed specially by the Islands act, and context of the Islands act (sec. 5) requires continued operation of section 3.

e) *Interstate Commerce Comm. v. Railway L. Ex. Asso.*, 315 US 373, 380: An administrative construction was discredited because "hostile to the major objective of the act." In the instant case, as will be shown hereinafter, the present administrative construction, here in question, which is based upon the concept of revenue to the American Treasury, is hostile to the dominating concept of revenue to the insular government.

The present pertinency of the foregoing enunciations of principle by the Supreme Court will now be made in detail.

3) *Purpose of Virgin Islands Act*: In the instant case the "light of the purposes which led to the enactment of the entire legislation" is especially clear. The measure is entitled "an act to provide a temporary government for the West Indian Islands acquired by the United States from Denmark" (39 Stat. 1132). The life blood of any government is its revenue, and, in this instance, the framework and mode of operation of the insular government having been established by sections 1 and 2, the raising and disposal of revenues were governed by sections 3-5, relating (a) to exactions made in this country on merchandise from Virgin Islands, and (b) to export duties and other taxes collected by the insular government, and (c) allocating all these revenues to the benefit of that government, by directing that "the duties and taxes collected in pursuance of *this act* shall not be covered into the general fund of the Treasury of the United States, but shall be used and expended for the government and benefit of said islands." This provision concerning collections under "this act," to wit, the original insular act of 1917, has never been revised or superseded. Therefore section 5

contemplates now, as it did originally, so far as internal taxes are concerned, only those levied "upon like articles imported from foreign countries."

The only revenue available to the insular government is that "collected in pursuance of *this*" original Virgin Islands Act. No other collections under American excise laws are assigned to that government; so that if section 3, a revenue-producing provision in the Virgin Island Act, should be regarded as superseded by later legislation, it would be necessary to distort the words in section 5 of the original statute, "collected under *this* act," so they would read, "collected under *any* act." Such judicial surgery should be resorted to only where unavoidably necessary; and it is here unnecessary, either to meet some exigency such as failure of insular revenues, or to comply with rules of statutory construction.

This obvious perversion of explicit legislative language can be avoided by construing the Virgin Islands Act, 48 USC 1394, and the later one, 26 USC 3350 (a), as having the same meaning despite the slight verbal difference. Such a construction would be reasonable because in accord with the manifest policy of the fundamental legislation governing fiscal relations between this country and the Islands.

It would also be reasonable because (a) of the incongruity and difficulty of applying processing taxes to merchandise produced outside the United States, because (b) of the incidental reversal of long-continued administrative practice in regard to Virgin Islands spirits, because (c) of present administrative usage concerning other phases of the rectification laws, and because (d) of pre-

sumed legislative approval of the practical Treasury construction of Virgin Islands statutes and of rectification statutes. These subjects will be dealt with under our headings 4-6 *infra*.

4) *Rectification tax applicable only to American products*: The Revenue Act of 1918, 26 USC 3350 (a), which provides for Island products "the internal revenue tax imposed in the United States upon like articles of domestic manufacture," may well be construed as referring only to the general tax on distilled spirits, and not to the rectification tax. If so, there is then no conflict between the two statutes, and plaintiff's contention that Island products are not subject to rectification tax should be sustained, and that phase of this suit thus disposed of.

The rectification tax is a special impost of a domestic type that is not suitable to extraterritorial administration and has only recently been applied by revenue officials to insular production and is still not considered applicable to spirits from foreign countries. In regard to these inconsistent official positions it will be helpful to consider the history of rectification statutes.

Apparently the first legislation on the subject was by Act of July 20, 1868, 15 Stat. 130, 150, which imposed so-called special taxes on many occupations in this country, ranging from brewing to peddling, and with some subsequent amendments was carried into RS 3244. The pertinent part of that section reads thus:

Sec. 3244. Special taxes are imposed as follows:

Third. Rectifiers of distilled spirits shall pay \$200. Every person who rectifies, purifies, or refines distilled spirits or wines by any process other than by original and continuous distillation from mash, wort,

or wash, through continuous closed vessels and pipes, until the manufacture thereof is complete, and every wholesale or retail liquor-dealer who has in his possession any still or leach-tub, or who keeps any other apparatus for the purpose of refining in any manner distilled spirits, and every person who, without rectifying, purifying, or refining distilled spirits, shall, by mixing such spirits, wine, or other liquor with any materials, manufacture any spurious, imitation, or compound liquors for sale, under the name whisky, brandy, gin, rum, wine, spirits, cordials, or wine bitters, or any other name, shall be regarded as a rectifier, and as being engaged in the business of rectifying: . . .

By no stretch of language could this provision be regarded as relating to anything but domestic operations. Occupational activities outside the United States are in no way implicated.

This special tax on domestic rectifiers of spirits has continued until the present time, being now found without substantial statutory change in 26 USC 3250 (f) (1) and 3254 (g), in part vii on "occupational taxes" on liquor.

The present tax on rectification differs from above-mentioned tax on rectifiers in that, instead of being occupational, it is a processing tax. It seems to have originated in Act of October 3, 1917, section 304, 40 Stat. 310, which as now found in 26 USC 2800 (a) (5) reads thus, so far as here pertinent:

(5) *Rectified Spirits and Wines*.—In addition to the tax imposed by this chapter on distilled spirits and wines, there shall be levied, assessed, collected, and paid, a tax of 30 cents on each proof gallon . . .

on all distilled spirits or wines rectified, purified, or refined in such manner, and on all mixtures produced in such manner, that the person so rectifying, purifying, refining, or mixing the same is a rectifier within the meaning of section 3254 (g): . . .

This reference to section 3254 (g), in which the language of RS 3244 (3), *supra*, is embodied, implicates the same exclusive purview of domestic products that was connoted by the latter.

This construction is strengthened by various other statutes, to wit:

a) 19 USC 2801 (b), relating to proof and volume of rectified spirits and providing:

When the process of rectification is completed and the taxes prescribed by section 2800 (a) (5) have been paid, it shall be unlawful for the rectifier or other dealer to reduce in proof or increase in volume such spirits or wine by the addition of water or other substance; nothing herein contained shall, however, prevent a rectifier from using again in the process of rectification spirits already rectified and upon which the taxes have theretofore been paid.

Comment: These provisions can relate only to processes subsequent to payment of tax in this country. On insular or foreign processing the tax would not have "been paid" or even accrued prior to arrival in the United States.

b) 19 USC 2801 (c)(1), on "exemption from tax," provides that:

. . . blended whiskies and blended fruit brandies shall be exempt from tax under section 2800 (a)(5) only when compounded under the immediate supervision of a revenue officer, in such tanks and under such

conditions and supervision as the Commissioner, with the approval of the Secretary, may prescribe.

Comment: This "immediate supervision of a revenue officer" could occur only in regard to domestic rectification, and regulations for "tanks and . . . conditions" could be enforced by the Commissioner only for domestic operations.

c) 26 USC 2801(e)(1)(2) authorize Treasury regulations, prescribe arrangement of premises, and impose penalties for misuse of premises. Same comment; also penalties would not be imposed for acts occurring outside the United States.

d) 26 USC 2801 (f), imposes penalties in connection with rectification violations. Same comment.

(e) 26 USC, part ii, on "distilling and rectifying," contains many other provisions of like implication, such as section 2812, on "notice of business of distiller or rectifier"; section 2813, on "notice of intention to rectify"; section 2828, on furnishing of ladders and other facilities to revenue officials for examination of rectification premises; sections 2831-3, on equipment, search of premises, and use of signs; sections 2855-7, on monthly returns of rectifier, unlawful rectifying, and records of rectifiers; sections 2860-2, on limited purchases by rectifiers, gauging, branding and stamping by government official, and form of stamping, and section 2865, on penalties for noncompliance with rectification statutes.

These numerous statutes in *pari materia* unanimously support appellant's contention that rectification taxes relate only to domestic production, the same as the special tax of \$200 on rectifiers is payable only by American



processors. It would be hard to find another case of statutory intent based on so many clear implications.

5) *Regulations*: There seem to be no published Treasury directives in relation to rectification taxes on foreign liquors in general. Therefore, in that regard the evidence that the tax has not been imposed is negative. However, for 28 years, as is well known in official and commercial circles, the tax has not been assessed.

As to Virgin Islands products the evidence is well documented, and in that regard appellant cites *infra* the published customs regulations of 1943, 1937, 1931, and 1923, all of which recognize the Virgin Islands Act of March 3, 1917, as applicable, and ignore 26 USC 3350 (a).

*Customs* regulations are pertinent because goods going to or coming from those islands, as with commerce with foreign countries, are subject to the usual customs requirements, and can be cleared through customs, whether inward or outward, only upon compliance with taxing statutes including collection of duties and internal taxes upon arrival, and the drawback of duties and taxes upon export. These regulations are more specifically as follows:

a) Customs Regulations 1943, section 7.9 on "Virgin Islands": While these regulations prescribe customs formalities for commerce between the United States and the Islands, of special value here is the fact that the basic statute cited is 48 USC 1394 (section 3 of the original Virgin Islands Act of March 3, 1917). It is quoted in full in the regulations, including this language:

There shall be levied, collected, and paid upon all articles coming into the United States or its possessions from the Virgin Islands the rates of duty and *internal-revenue taxes* which are required to be levied,

collected, and paid upon like articles imported from *foreign countries*: . . .

b) Customs Regulations 1937: Article 272 is similar to section 7.9 in the regulations of 1943 *supra*, and embodies the same statutory quotation from 48 USC 1394.

c) Customs Regulations 1931: Article 267 likewise includes the Virgin Island provision in full.

d) Customs Regulations 1923: Article 245 cites "Act Mar. 3, 1917, sec. 3," and, while the statute is not quoted, also cites Treasury Decision 37089 of April 3, 1917, which, for "information and guidance" of "collectors of customs," publishes the act in full, containing the involved provision concerning internal-revenue taxes upon like articles imported from foreign countries.

Thus, in administering the law relating to merchandise coming into the country from Virgin Islands, both for customs and for internal-revenue purposes (26 CFR 180.5), the American customs service was for many years acting under published Treasury instructions which even now recognize section 3 of the Virgin Islands act as operative and give no weight whatever to the theory that the provision in that act for "like articles imported from foreign countries" was altered in meaning by the words in the Revenue Act of 1918, "like articles of domestic manufacture."

However, the Treasury has not been entirely consistent. This appears from an internal-revenue regulation published on October 25, 1937 as TD 4770, which is now embodied in 26 Code Fed. Reg. 180, and relates to "collection of internal-revenue tax on intoxicating liquors . . . coming into the United States from . . . the Virgin Islands."

This regulation entirely ignored section 3 of the Virgin Island act but referred to section 1304 of the revenue act of 1918, now 26 USC 3350 (a). After mentioning that distilled spirits from the Islands "are subject to the rates imposed upon domestic products of the same kind by the internal-revenue laws," the regulation added (26 CFR 180.1):

. . . Rectification tax on rectified distilled spirits or wines at the rate of 30 cents per proof gallon is also collectible . . . if the product so rectified would be subject to that tax if manufactured in the United States.

In *Interstate Comm. Comm. v. Railway L. Ex. Assn.*, 315 US 373, 380, the earlier one of conflicting interpretations by the commission was adopted, though other reasons were also given for the conclusion reached.

So it appears that the Treasury was consistent until October 1937, but that since then customs regulations have recognized section 3 of the Virgin Islands Act, while internal-revenue regulations have disregarded it! Under such circumstances the rule concerning the weight to be imputed to long-continued administrative construction is hardly weakened by the head-on collision between two Treasury bureaus which in 1937 created an impasse that still persists, especially in view of the fact that the Treasury attitude that imposes rectification taxes on Island spirits is inconsistent with the continued administrative exemption of foreign products from those taxes.

Further, in the court below appellee conceded that "the rectifying tax was not collected on distilled spirits brought in from the Virgin Islands prior to the promulgation of

T.D. 4770," in October 1937, thus confirming above statements as to uniform practice during the previous 20 years.

Pertinent to the long administrative usage which was interrupted in 1937, is the fact that in June 1926 the Attorney General, 35 Opns. 63, reviewed the internal tax laws concerning distilled spirits with possible reference to Virgin Islands, including both the fundamental statute of March 3, 1917, containing the words "like articles imported from foreign countries," and the revenue provision containing the words "like articles of domestic manufacture," and his extensive discussion contains no suggestion of conflict between those phrases, and no suggestion that the rectification tax applied to Island products.

6) *Effect of long-continued administrative construction:* In April, 1917, Treasury Decision 37089 published in full for official guidance the Act of March 3, 1917, 39 Stat. 1132, imposing upon Island products the internal-revenue taxes which were payable "upon like articles imported from foreign countries." The Revenue Act of 1918, section 1304, 40 Stat. 1142, 26 USC 3350 (a), provided on Island products a "tax equal to the internal-revenue tax imposed in the United States upon like articles of *domestic* manufacture."

As noted above, in 1923, 1931, 1937, and 1943, the Treasury promulgated general regulations which cited the earlier act as pertinent to shipments from the Islands; that is, there was no recognition of a possible difference between internal taxes upon "articles imported from foreign countries" and "articles of domestic manufacture." Since 1917 there have been about a dozen comprehensive revisions of internal-revenue laws and several re-

visions of customs laws, together with a number of enactments relating specially to the Islands, though on other subjects. See 48 USC 1391-406.

Congress is presumed to have been aware of these Treasury promulgations during a 20-year period and of the fact that during all that time the rectification tax had not been applied to Island products. If this long and uniform practice had been regarded as erroneous, corrective legislation would doubtless have occurred; but there has been none.

An administrative practice which existed undisturbed from 1917 to 1937 and concerning which the regulations have been conflicting since 1937 should now be followed. As said in *Border Line Transp. Co. v. Haas* (CCA 9), 128 F.2d 192, syllabus 1:

Departmental construction of statute for nearly half a century was entitled to great weight and would not be upset except for the most cogent reasons.

In *US v. Jackson*, 280 US 183, are found two pronouncements that are here pertinent: In syllabus 5, 74 L.ed. 361:

The silence of Congress in the face of a long-continued practice of an executive department involving the construction of a federal statute must be considered as equivalent to consent to continue the practice.

In syllabus 4, ib.:

Great weight is properly to be given to the construction consistently given to a statute by the executive department charged with its administration; and such construction is not to be overturned unless clearly wrong, or unless a different construction is plainly required.

Note, also, *US v. Alabama G. S. R. Co.*, 142 US 615, 621, saying:

We think the contemporaneous construction thus given by the executive department of the government, and continued for nine years through six different administrations of that department—a construction which, though inconsistent with the literalism of the act, certainly consorts with the equities of the case—should be considered as decisive in this suit. It is a settled doctrine of this court that, in case of ambiguity, the judicial department will lean in favor of a construction given to a statute by the department charged with the execution of such statute, and, if such construction be acted upon for a number of years, will look with disfavor upon any sudden change, whereby parties who have contracted with the government upon the faith of such construction may be prejudiced.

Further, as said in *Merritt v. Welsh*, 104 US 694, 704 (emphasis added):

. . . If experience shows that Congress acted under a mistaken impression, that does not authorize the Treasury Department or the courts to take the part of legislative guardians and, by construction, to make new laws which they imagine Congress would have made had it been properly informed, *but which Congress itself, on being properly informed, has not, as yet, seen fit to make.* . . .

Other pertinent citations are these:

*Hahn v. US*, 107 US 402, 405;

*US v. Hill*, 120 US 169, 182;

*US v. Cerecedo*, 209 US 337, 339;

*US v. American Trading Assn.*, 310 US 534, 543.

In view of these various decisions, little weight should be given to the fact that TD 4770, October 1937, contained instructions in violation of an established practice based on reiterated promulgations.

## II) The Rum Was Not Rectified

Appellant's cause of action does not necessarily depend upon whether the Virgin Islands Act of 1917 applies to exclusion of the Revenue Act of 1918. If the Virgin Islands Act is paramount, then the 30 cent tax was improperly assessed *whether or not* the rum was rectified. And if the Revenue Act of 1918 is paramount then the question of fact arises as to whether this rum was rectified.

This tax is levied under the provisions of 26 USC 2800 (a)(5) and 26 USC 3254 (g) set forth in the appendix hereto. It is not levied upon any enumerated articles but upon distilled spirits "rectified, purified or refined *in such manner* and on all mixtures produced *in such manner*, that the person so rectifying, purifying, refining or mixing the same is a rectifier within the meaning of section 3254 (g)" (26 USC 2800 (a)(5)). In other words, mixtures of spirits are taxable at the 30-cent rate only if the person "mixing the same" is a person described in section 3254 (g).

The persons described in section 3254 (g) are those who perform several distinct operations, to wit: a) rectifying, purifying, or refining distilled spirits, and (b) mixing spirits "with any material." However, the section is explicit in stating that by the mixing referred to the person *must* "manufacture" either "spurious," "imitation," or "compound liquors," for sale.

Two of the processes enumerated in this statute (purifying and refining) obviously did not occur here, because the addition of caramel (formula 7), the blending with other rum (formulas 2 and 10), or the treatment with darco carbon (formulas 11 and 12) did not constitute purification or refining. Also, these processes did not constitute rectifying, for as stated in *Wampole v. US*, 191 F 573, 576:

. . . rectification of distilled spirits, in a legal sense, means the process . . . by which the spirits are *separated* from the substance with which it is mixed or combined.

Therefore the only possible question is whether, by virtue of the mixing and blending referred to above, "spurious, imitation or compound liquors" were *manufactured*. Upon this point it may be first observed that the recited formulas do not *per se* establish that spurious, imitation or compound liquors were manufactured by the processes referred to. Therefore defendant's motion below, insofar as it relates to this court, should have been denied. However, it may also be observed that appellant intended to establish by evidence that this rum was not a spurious liquor or an imitation liquor, and that the mixing, as alleged in the complaint, did not result in the "manufacture" of compound liquor. Consequently, it is submitted that in the absence of such evidence the court below was unable to determine whether appellant's complaint stated a cause of action.

In the court below, defendant referred to *US v. Quantity of Distilled Spirits*, Fed. Cas. 11494, and *Michel v. Nunn*, 101 F 423, as authorities for the statement that



“there certainly can be no doubt that the rum . . . was rectified.” These decisions, however, do not support this contention. Federal Case 11494 related to a penalty imposed against a rectifier for failure to make a proper record of the receipt of distilled spirits as required by statute, *the only issue being whether such records had been made*. However, the court also quoted the statute defining rectifiers, now found in 26 USC 3254 (g), and stated that it was not disputed that the defendants were rectifiers (p. 108). Therefore the decision is not pertinent to the question of whether the instant merchandise was rectified.

Although the second case cited by defendant below, *Michel v. Nuun*, involved the question whether rectification had occurred, it is submitted that the court’s conclusion therein is not binding here, because (a) it is contrary to subsequent departmental practice interpreting the statute; (b) the facts in that case do not disclose whether a spurious, imitation, or compound liquor was manufactured; and (c) the result of such mixing as there occurred is not comparable with the result in the instant case. Factually the *Michel* case involved a retail liquor dealer who, as shown by the opinion, mixed whisky, sugar, and water, or reduced the proof of whisky by the addition of water and added coloring matter (blackberry juice) to the diluted whisky. As to these facts the court held that the dealer was a rectifier because he mixed liquor “with any material.” But error in the court’s conclusion is indicated by the fact that the statute was interpreted to include *all mixing of any material*, regardless of whether by such mixing a

spurious, imitation, or compound liquor was manufactured.

Also, the court stated that there would not be any doubt that under the statutes in question the Commissioner of Internal Revenue could require a person mixing “*either* water or sugar” with spirits to pay tax as a rectifier. However, appellant represents to this court that for the last 75 years the statute has been administratively interpreted so as to exclude the mixing of water and spirits from its scope. Also, under current internal-revenue regulations (26 Code of Fed. Reg. 184.245) it is permissible, after distillation has been completed, to mix burnt sugar or caramel with brandy without incurring the rectification tax. Therefore it is submitted that the cited decision is not authoritative.

Further, on the question of whether this mixing or blending “manufactured” a compound liquor, as required by the statute, the decision in *Anheuser-Busch v. US*, 207 US 556, is pertinent. Therein it was said (p. 562):

Manufacture implies a change, but every change is not a manufacture, and yet every change in an article is the result of treatment, labor, and manipulation . . . something more is necessary, . . . There must be a transformation; a new and different article must emerge having a distinctive name, character, or use

Therefore, it was appellant’s purpose in the District Court to show by competent evidence that the rum in question did not acquire, by virtue of the processes set forth in the formulas, a “distinctive name, character, or use.”

### III) The Rum Was Not Produced by a Rectifier

Independent of the above points is also a question of law as to whether a Virgin Islands product which has in fact been produced by a process of rectification, purification, etc., is subject to rectification tax under 26 USC 2800(a)(5). Appellant asserts that such merchandise would not be so taxable, because the statute relates to products which are produced "in such manner, that the person so rectifying . . . is a rectifier within the meaning of section 3254 (g)." Consequently, as producers of spirits within the Virgin Islands Act are not considered to be "rectifiers" within the meaning of 3254 (g), the spirits produced or processed by such persons are not taxable at the 30-cent rate.

### IV) The Distilled-Spirits Tax Was Collectible Upon the Proof-Gallon Basis

Regardless of whether the Virgin Islands Act or the Revenue Act of 1918 be relied upon, appellant contends that the distilled-spirits tax should have been assessed upon the basis of the proof gallon.

Pertinent effects flowing from application of either act are as follows:

1) *Virgin Islands Act*: If this act be applicable, all products coming into the United States from the Virgin Islands are subject to "the rates of duty and internal-revenue taxes which are required to be levied . . . upon like articles imported from foreign countries."

The British Trade Agreement of 1939 (TD 49753, 54 Stat. 1897) relates to "rum in containers holding each one gallon or less" (schedule IV, paragraph 802), and

by article XII it is provided that merchandise specified in schedule IV shall, upon importation into the United States, be exempt from:

. . . duties, taxes, fees . . . imposed in connection with importations *in excess* of those imposed on the day of the signature of this agreement . . .

However, by article XIV it is stated that the provisions of said article XII:

shall not prevent the imposition at any time on the importation of any article of a *charge equivalent* to an internal-revenue tax imposed in respect of a like domestic article . . .

In 1939, when this trade agreement was entered into, the rate of tax upon domestic and foreign rum was \$2.25 per gallon. As to British rum the amount of this tax was thus "frozen" by aforesaid article XII and by virtue of the generalization clause in the Trade Agreement Act of June 12, 1934, 48 Stat. 943, 19 USC 1351 (set forth in the appendix) the benefit thus given to the United Kingdom applied "to articles the growth, produce, or manufacture of *all* foreign countries, whether imported directly or indirectly." However, by article XIV of said trade agreement, the United States reserved the right to collect upon foreign rum "*a charge equivalent to*" the internal-revenue tax imposed upon a *like* domestic article.

When the rate of tax was subsequently raised by Congress to \$3 and \$4 per gallon, and when, as here, it was applied to the wine gallon, the immediate result was that the *amount* of tax thus collected exceeded the *amount* of

tax collected upon "a like domestic article," because all domestic distilled spirits are originally distilled at more than 100 proof and therefore taxes upon the proof gallon basis rather than the wine gallon basis.

Therefore, the instant distilled-spirits tax of \$3 and \$4 per *wine* gallon would be excessive if the merchandise had been imported from England or other non-discriminating foreign countries. Consequently under the Virgin Islands Act of 1917, such taxes, being measured by the tax required to be levied "upon like articles from foreign countries," were likewise excessive.

In regard to the effect of the British Trade Agreement defendant below argued that:

Trade agreements with foreign countries have no application to possessions of the United States (*De Lima v. Bidwell*, 182 US 1).

This is correct. However, appellant does not seek to apply the trade agreement to the Virgin Islands but merely relies upon the agreement as establishing the taxable status for foreign rum. Therefore, as Virgin Islands rum is taxable (as provided by the 1917 act) at:

the rates of . . . internal revenue taxes which are required to be levied . . . upon like articles imported from foreign countries

then the rate of tax upon "like articles imported from foreign countries" must be found. Consequently the trade agreement is pertinent.

2) *The 1918 Revenue Act*: With regard to the distilled-spirits tax upon Virgin Islands products, when based upon the Revenue Act of 1918, the same result is obtained, i.e., taxation should be upon the proof-gallon

basis. The 1918 act (now 26 USC 3350) required such products to pay:

A tax equal to the internal revenue tax imposed in the United States upon like articles of domestic manufacture.

All domestic distilled spirits, such as rum, are distilled at not less than 160 proof and are taxed accordingly, i.e., upon the proof gallon. Consequently the instant rum, having been distilled at more than 100 proof (paragraph II of complaint) is taxable upon the proof-gallon basis, the same as "like articles of domestic manufacture" are taxed.

In addition pertinent Treasury regulations specify that the internal tax upon Virgin Islands products shall be assessed upon the proof-gallon basis "regardless of the proof of the spirits at the time of their entry into the United States," provided the insular gauger's certification shows "that the spirits covered thereby were 100 degrees or more in proof at the time they were withdrawn from the *insular* bonded warehouse." See 26 CFR, 1941 supp., 180.134 (a) set forth in the appendix.

Consequently, as the Treasury Department has determined that underproof Virgin Islands spirits are taxable upon the proof-gallon basis where the original spirits were withdrawn from insular bonded warehouse at proof or over, the real question here is whether compliance with such regulation, i.e., the furnishing of an insular gauge certificate, is a condition precedent to recovery of taxes wrongfully assessed.

This question is readily answered by the fact that the regulation in question (26 CFR, 1941 supp., 180.134 (a))

was not promulgated until June 16, 1941, whereas some of the instant merchandise arrived in the United States prior to that date.

Also, as to the merchandise which arrived after June 16, 1941, it is well settled that regulations prescribed under the general supervisory authority of the Secretary of the Treasury and relating to a method of proving a tax status or to prevent fraud are not exclusive and that proof according to rules of evidence is permissible. A decision by Judge Sawyer of this circuit is closely in point: *Pascal v. Sullivan*, 21 F 496, a customs case in which it was contended that imported merchandise was free of duty as "natural mineral waters." A Treasury regulation had prescribed a certain form of certificate as to the character of the water, and it was argued that the Secretary had legally refused to receive any other evidence. This contention was overruled, the court saying (p. 500):

While the regulation may, perhaps, be a proper one (I am not prepared to hold that it is not) for the convenient administration of the customs laws by the collectors of ports, it would be in my judgment wholly unreasonable to make it conclusive upon the rights of the parties when they appeal to the courts of the country to recover the excess of duties in fact exacted and paid; and, in my judgment, no authority is vested in the secretary to give the regulation such effect. To give it such effect would be to change the law of the land as to the competency of evidence, and the statutes prescribing the rate of duties that shall be collected. If the law of the land, in this instance, can be thus changed by an arbitrary rule of the secretary of the

treasury, I do not perceive why it might not in like manner be changed in any other particular relating to the administration of the treasury department.

Other pertinent decisions on this point are *US v. Goodsell* (CCA 2), 91 F 519; *Siegfried v. Phelps*, 40 F 660, also by Judge Sawyer; *Anglo-California Bank v. Secretary* (CCA 9), 76 F 742, 749-50, and *Campbell v. US*, 107 US 407, 410.

#### V) The Distilled-Spirits Rate Should Not Exceed \$2 Per Gallon

For reasons stated above it is contended that the tax is to be measured by the rate applicable to "like articles imported from foreign countries" (Virgin Islands Act of 1917).

Rum of the character here involved (in containers holding one gallon or less) is enumerated in schedule II of the Haitian Trade Agreement of March 28, 1935, 49 Stat. 3737, TD 47667, and as to such merchandise the trade agreement provides (article II):

Articles, the growth, produce or manufacture of the Republic of Haiti, enumerated and described in schedule II . . . shall, on their importation into the United States of America, be exempt from all ordinary customs duties in excess of those set forth in said Schedule, *and from all other duties, taxes, fees, charges, or exactions, imposed on or in connection with importations, in excess of those imposed or required to be imposed by laws of the United States of America in effect on the day of the signature of this Agreement.*

and in view of the generalization clause of the Trade Agreement Act of June 12, 1934, 48 Stat. 943, 19 USC



1351 (set forth in the appendix) the benefit thus given to Haiti applied "to articles the growth, produce, or manufacture of *all* foreign countries, whether imported directly or indirectly."

On the day of signature of that agreement the "distilled spirits" tax applicable to imported rum was \$2 per gallon, under Revenue Act of 1918, section 600, as amended by Liquor Taxing Act of 1934, 26 USC 1934 ed., 1150 (a). It is here contended that statutes enacted subsequently to the Haitian agreement, which raised the tax upon "distilled spirits" to \$2.25, to \$3 and \$4 per gallon (sec. 710, Revenue Act of 1938; sec. 213, Revenue Act of 1940; and sec. 533, Revenue Act of 1941), should be construed as not revoking the trade agreement, but should be applied to all distilled spirits except those enumerated in the agreement.

The principle of law supporting this contention is so well known as not to require citation, it being that treaties and acts of Congress are of equal force; that if possible courts must construe each so as to give effect to both, and that the earlier will not be deemed to have been abrogated by the latter unless such conclusion is absolutely essential or unless the purpose of Congress to repeal one by the other is clearly expressed.

With this rule as a basis it may be seen that the treaty with Haiti "froze" the rate of internal-revenue tax on rum when packed in specified containers at \$2 per gallon. Also, in later acts, Congress by use of general language, "distilled spirits," changed the \$2 rate to \$2.25, then to \$3 and then to \$4 per gallon. Consequently, as the provisions of the Haitian agreement were, by virtue of the gen-

eralization provision of the Trade Agreement Act of June 12, 1934, 48 Stat. 943, 19 USC 1351, extended to all foreign countries, the correct rate upon "like articles imported from foreign countries" (Virgin Islands Act of 1917) is still \$2 per gallon. Therefore the instant distilled spirits tax should have been that amount.

The court will find that in *United States v. Rathjen*, 31 CCPA (Customs) 70, 177 F2d 103, it was held that a clause in the Cuban Trade Agreement of 1934, similar to above-quoted article II of the Haitian Agreement, did not have the effect of "freezing" the rate of internal-revenue tax on rum and that the Revenue Act of 1938, being of later date, served to repeal said Cuban treaty or trade agreement.

However, that decision is not controlling here, because:

1) The Revenue Act of 1938 also amended the law relating to the import tax on lumber, but the act provided (sec. 704) that the amendment should not be effective if "in conflict with any international obligation of the United States."

2) Because of this provision the Court of Customs and Patent Appeals said:

From the above-quoted language it is plain to us that the Congress in enacting the said revenue act had clearly in mind the international obligations of the United States such as the one here involved, and if it had intended that merchandise from Cuba such as in the instant case was to be excepted from the scope of that act it would have so stated as it did with respect to the tax on lumber.

This consideration is not present with regard to the revenue acts of 1940 and 1941. Therefore the *Rathjen* case

is not an adverse precedent to plaintiff's contention, and consequently if the court concludes that Virgin Islands rum is taxable at the rate applicable to "like articles imported from foreign countries," it must also determine whether the revenue acts of 1938, 1940, and 1941 were in conflict with and repealed article II of the Haitian Trade Agreement.

Upon this point and in regard to *US v. Rathjen* supra, the following is pertinent: Present counsel for appellant were also counsel for the appellee in that case and therefore know that the argument which follows was not presented to the Court of Customs and Patent Appeals in that appeal. Consequently the *Rathjen* case is not *stare decisis*.

1) *No conflict created by statute of 1938*: By section 710, Revenue Act of 1938 (c. 289, 52 Stat. 572), Congress enacted the following provision:

Sec. 710. Tax on Distilled Spirits.

(a) Section 600 (a)(4) of the Revenue Act of 1918, as amended, is amended to read as follows:

"(4) on and after January 12, 1934, and until July 1, 1938, \$2.00, and on or after July 1, 1938, \$2.25, on each proof or wine gallon when below proof and a proportionate tax at the like rate or all fractional parts of such proof or wine gallon."

This legislation was amendatory of the Revenue Act of 1918 as amended, to the extent (1) of changing the rate of tax therein provided, and (2) of specifying periods of time during which the new rate applied. Therefore it is here claimed to be an act of Congress not in conflict with the trade agreement of 1935 because by this amendment Congress did not, in 1938, as held in the *Rathjen* case,

enact a "statute providing that *all distilled spirits imported into the United States* should be subject to an internal-revenue tax of \$2.25 per proof gallon" (italics quoted).

By section 600 (a), Revenue Act of 1918, Congress had provided that "all distilled spirits . . . that may be . . . hereafter imported into the United States" should be taxed at \$2.20 per gallon. By the Revenue Act of 1926 (sec. 900) this language was reenacted in the form of an amendment, but with different rates specified. On January 11, 1934 (Liquor Taxing Act of 1934), section 600 of the Revenue Act of 1918 as amended was again amended, but only to the extent of changing the rate of tax. Then by article II of the Haitian agreement the rate in effect *at that time* was "frozen."

Therefore, section 710 of the Revenue Act of 1938, by which Congress merely changed the *rate* of tax, should not be construed as being an enactment *in 1938* of the provision found in section 600, Revenue Act of 1918, namely, that *all* imported distilled spirits were taxable at the new rate of \$2.25 per gallon.

On the contrary, the act of 1938 should be construed to accord with the terms of the prior agreement, with the result that after the effective date of said act all imported distilled spirits, *except* those covered by the Haitian agreement, were subject to the new rate. This accords with the principle of statutory construction referred to in the following:

a) *Commonwealth v. Howes*, 270 Mass. 69, considered an amendment granting to municipal authorities the power to prohibit the taking of fish. The original statute author-

ized these authorities to "control and regulate" such taking, and the amended statute added to this phrase the words "or prohibit." As to the amendment it was said (p. 72):

. . . When adopted, the legislative amendment became a part of the original statute to the same extent as to everyone as if always contained therein unless the amendment involves the abrogation of contractual relations between the State and others. *Fitzgerald v. Lewis*, 164 Mass. 495, 499; *Wheelwright v. Tax Commissioner*, 235 Mass. 584, 585.

b) *Allison v. Hatton*, 46 Or. 370, relates to the tax status of certain land in Oregon which by an act of 1885 had been incorporated within the boundaries of Columbia county. In 1898 an act amending an independent act of 1895 established boundaries for Washington county, including therein a strip of land which was then a part of Columbia county. In 1901 an act amending the original act of 1885 changed the boundaries of Columbia county so as to include land not theretofore in any county. In addition, this act of 1901 reenacted the act of 1885 (as it then appeared in section 2251, Hill's Ann. Laws of 1887) by stating that section 2251 "is hereby amended to read as follows," and then setting forth the section in full as originally enacted, without reference to the act of 1898 which had given to Washington county a portion of the land originally included in Columbia county. As to these facts the court said (p. 372):

. . . The act of 1901, amending section 2251, so far as the question here involved is concerned, is not a new legislative declaration on the subject of boundaries of the county, but merely a restatement or re-

publication of the law as it existed prior to the act of 1898, *and therefore not in conflict with the latter act, and does not repeal by implication*. The rule is that where a section of the statute is amended so as to read "as follows," and the section is then set forth with the changes intended to be made, those portions of the old section that are merely copied into the amendment without change are not to be considered as reenacted or as a new statement of the law, but are to be read as a part of the earlier statute, if in conflict with another law passed after the section amended and before the amendatory act, unless there is a clear manifestation of legislative intention to the contrary. In the absence of such intention, it is the change or additions incorporated in the section amended only that are to be considered enacted. This doctrine has been several times applied by this court, and is supported by authorities. *Endlich*, *Interp. Stat.*, sec. 194; *Stingle v. Nevel*, 9 Or. 62; *Eddy v. Kincaid*, 28 Or. 537 (41 Pac. 156, 159); *Small v. Lutz*, 41 Or. 570 (67 Pac. 421, 69 Pac. 824).

c) *Endlich on Interpretation of Statutes*, thus referred to by the Oregon court, states (sec. 194):

It has been held that where a statute merely reenacts the provision of an earlier one, it is to be read as part of the original statute, and not of the reenacting one, if in conflict with another passed after the first, but before the last act; and therefore does not repeal by implication the intermediate one.

d) *Stingle v. Nevel*, 9 Or. 62: Here, upon somewhat the same subject, it was said with respect to a reenacted statute which appeared to conflict with an intermediate one (p. 64):

In *Ely v. Horton*, 15 N.Y. 597, it was held that where a section of a statute "is amended to read as follows," and the section is then set forth with the changes to be made, those portions of the old section that are merely copied without change, are not to be considered as repealed and reenacted, but such portions remain in force from the first enactment. It is the changes, or additions, incorporated into the section amended that are enacted. *S. P. Moore v. Mansert*, 49 N.Y. 332; *People v. Supervisors*, 67 N.Y. 109; *Burwell v. Tullis*, 12 Minn. 486; *Alexander v. State*, 9 Ind. 339.

The court then held that the republication of the Oregon statute was "not a re-enactment."

e) *City of St. Louis v. Alexander*, 23 Mo. 483: And here it was held (p. 509):

. . . Now the effect of the revision of the charter, on the 3d of March, 1851, was, not to make former provisions, which had previously existed, and were continued, to begin from that date, but for convenience sake to embody all the acts in relation to the charter into one law, leaving the acts in force at the time of the revision to take date from the period when they were first passed. It would be of the most mischievous consequence to hold that the revision of a law had the effect of making the revised law entirely original, to be construed as though none of its provisions had effect but from the date of the revised law. When a former provision is included in a revised law, it is only thereby intended to continue its existence, not to make it operate as an original act to take effect from the date of the revised law. The revision has not the effect of breaking the continuity of those provisions which were in force before it was made.

f) See, also, *City of Cape Girardeau v. Riley*, 52 Mo. 424, stating (p. 429):

. . . The revision of a law does not have the effect of making the revised law entirely original, so as to be construed as though none of its provisions had effect but from the date of the revised law.

When a former provision is continued in a revised law, it operates only as a continuance of its existence, and not as an original act. (*St. Louis v. Alexander*, 23 Mo. 509.)

g) Upon this subject it is said in Sutherland's Statutory Construction, 3d ed., sec. 1933:

Provisions of the original act or section which are repeated in the body of the amendment, either in the same or equivalent words, are considered a continuation of the original law. . . . The provisions of the original act or section reenacted by the amendment are held to have been the law since they were first enacted, and the provisions introduced by the amendment are considered to have been enacted at the time the amendment took effect. Thus, rights and liabilities accrued under provisions of the original act which are reenacted are not affected by the amendment.

h) *US v. La Franca*, 282 US 568: Here the court had before it the direct question of whether section 701, Revenue Act of 1924, reenacting certain provisions of the Revenue Act of 1918, should be considered to be a statute "in force when the National Prohibition Act (of 1919) was enacted." As to this it was said (pp. 571-2):

This section was passed in lieu of a similar provision in the Revenue Act of 1918, repeated by the Revenue Act of 1921. The government, accordingly,



treats the item sought to be recovered under section 701 as having been imposed by an act in force prior to the National Prohibition Act. With that view we agree.

i) *People v. New York C. & St. L. R. Co.*, 316 Ill. 452: The legislature by an act of 1917 had modified an act of 1901 by excluding the taxes of certain districts from the provisions of said act of 1901. In 1919, 1921, and 1923 the original act of 1901 was reenacted in connection with the adoption of certain amendments thereto, but no reference was made to the act of 1917. Upon these facts the court said in respect to the question of whether the laws of 1919, 1921, and 1923 were in conflict with and operated as a repeal of the 1917 statutes (pp. 457-8):

. . . Moreover, when the General Assembly amends a statute and no change is made in parts of it, the repeated portions, either literally or substantially, are regarded as a continuation of the existing law and not as the enactment of a new law upon the subject. *People v. Lloyd*, 307 Ill. 23; *Svenson v. Hanson*, 289 Ill. 242. The amendments to section 2 of the act approved May 9, 1901, made in 1919, 1921 and 1923, were not enactments of new laws upon the subject of the levy and extension of taxes, but constituted merely the continuation of the existing law with the respective amendments added, modified by section 17 of the act approved May 17, 1917, as amended. There is no repugnancy between the two.

In most of the cited cases the legislative bodies, when amending the prior statutes, repeated their provisions and added the desired changes. Yet the courts held that such repetition was not a reenactment of the original statutes

as of the date of amendment, but, as so appropriately stated in *People v. New York* supra, "merely the continuation of the existing law with the respective amendments added, *modified* by section 17 of the act approved May 17, 1917, as amended."

In the present case Congress in 1938 did not restate the terms of the Revenue Act of 1918 as amended, but merely (1) amended that portion which had specified the rate of tax, and (2) specified the effective date of the new tax. Therefore, The Revenue Act of 1938 was not an enactment in 1938 that "*all distilled spirits . . . that may be hereafter . . . imported into the United States*" should be taxed at \$2.25 per gallon.

In presenting this last point due regard has been given to the fact that when laws are amended the amended act is usually construed, as to subsequent occurrences, as if it had been originally enacted in the amended form. *US v. La Franca*, 282 US 568, 571-2; *Blair v. Chicago*, 201 US 400, 475; *Pennsylvania Co. v. US*, 236 US 351, 362. But, as is shown by the above authorities, this rule does not apply in cases such as the present, particularly when by an intervening act or event rights have been created which would be violated if the amendment were considered as an enactment of the original statute upon the date of amendment.

For reasons stated above appellant contends that the Revenue Act of 1938 and the Haitian agreement of 1935 are not irreconcilable and that Article II of the agreement was not repealed by the statute.

2) *Effect of enactment of the Internal-Revenue Code of 1939*, c. 2, 53 Stat. 1:

By section 4 of said act "all general laws of the United States and parts of such laws, relating exclusively to internal revenue, in force on the 2nd day of January 1939," were repealed and there was reenacted without change as section 2800 (a)(4), *supra*, the then existing statute relating to taxes on imported distilled spirits.

This section, being merely a reenactment of an existing statute, did not supersede the prior trade agreement, for there is no evidence of such an intention by Congress. The situation therefore resembles that passed upon in *Bill v. US*, 27 C.C.P.A. (Customs) 26, 104 F(2d) 67, involving (1) a treaty with Germany dated in 1925, and (2) paragraph 371 of the Tariff Act of 1930 as to which it was said:

At the time of the enactment of the 1930 tariff act the German treaty was the only one of its type which had been ratified and embodied in the statutes at large, *and we find no history connected with the passage of the tariff act which indicates any intention on the part of Congress to abrogate or supersede that treaty.*

Another pertinent decision upon this point is *Cook v. US*, 288 US 102, relating to a treaty dated in 1924 and to the tariff acts of 1922 and 1930. In this case it was specifically contended by petitioner that "Congress did not intend to alter the status and effect of the Treaty of 1924 when it reenacted, in 1930, sections 581 and 584 of the Tariff Act of 1922, and the treaty amounts to a limitation on these sections," and as to this the court said:

(P. 107:). The main question for decision is whether sec. 581 of the Tariff Act of 1930 . . . is modified, as applied to British vessels suspected of being en-

gaged in smuggling liquors into the United States, by the Treaty between this country and Great Britain proclaimed May 22, 1924. *That section—which is a reenactment in identical language of section 581 of the Tariff Act of 1922 . . . declares . . .*

\* \* \* \* \*

(P. 118:) Second, The Treaty being later in date than the Act of 1922, superseded, so far as inconsistent with the terms of the Act, the authority which had been conferred by section 581 upon officers of the Coast Guard . . .

\* \* \* \* \*

(P. 119:) *Third, The Treaty was not abrogated by reenacting section 581 of the Tariff Act of 1930 in the identical terms of the Act of 1922.* A Treaty will not be deemed to have been abrogated or modified by a later statute unless such purpose on the part of Congress has been clearly expressed. *Chew Heong v. United States*, 112 US 536; *United States v. Payne*, 264 US 446. Here the contrary appears. The committee reports and the debates upon the Act of 1930, like the reenacted section itself, make no mention of the Treaty of 1924.

Also, in accordance with the decisions referred to above pertaining to the effect of the Revenue Act of 1938, the Internal Revenue Code of 1939, being merely a reenactment of existing statutes, should not be considered as being new legislation in conflict with rights created by the intervening trade agreement. Therefore it should be held that this act did not affect the preferential status of foreign rum secured by the Haitian agreement of 1935.

3) *Effect of the Revenue Act of 1940*, C. 419, 54 Stat. 524, and *the Revenue Act of 1941*, C. 412, 55 Stat. 708:

Pertinent portions of these acts read as follows:

Revenue Act of 1940:

SEC. 213. DISTILLED SPIRITS.

(a) Section 2800 of the Internal Revenue Code is amended by inserting at the end thereof the following new subsections:

“(g) DEFENSE TAX FOR FIVE YEARS.—In lieu of the rates of tax specified in such of the sections of this title as are set forth in the following table, the rates applicable with respect to the period after June 30, 1940, and before July 1, 1945, shall be the rates set forth under the heading ‘Defense-Tax Rate’:

“Section	Description of Tax	Old rate	Defense-tax rate
2800(a)(1)	Distilled spirits generally	\$2.25	\$3.”

Revenue Act of 1941:

SEC. 533. DISTILLED SPIRITS.

(a) Rate on Distilled Spirits.—Section 2800 (a)(1) of the Internal Revenue Code is amended by striking out “at the rate of \$2.25 (and on brandy at the rate of \$2)” and by inserting in lieu thereof “at the rate of \$4”, and by striking out “(except brandy).”

Because each of these laws merely amends the law in effect upon the date of the Haitian agreement with regard to the *rate* of tax, neither should be construed as repealing the agreement by implication. See argument above with respect to the Revenue Act of 1938.

Therefore the issue to be decided is whether acts of Congress are to be construed as nullifying a prior trade agreement when no evidence exists as to such an inten-

tion. If it is found that the trade agreement guarantee of a rate of tax equal to \$2 per gallon is still in effect, then Virgin Islands rum is taxable at that rate under the Virgin Islands Act of 1917.

#### VI) Conclusion

It is respectfully submitted that the court below erred in dismissing appellant's complaint and the judgment appealed from should be reversed and the cause remanded.

San Francisco, January 25, 1946.

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(APPENDIX FOLLOWS)

## Appendix

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- (a) Virgin Islands Act of March 3, 1917, section 3, 39 Stat. 1133, 48 USC 1394, relating to internal-revenue taxes upon Virgin Islands products:

SEC. 1394. Customs duties and internal-revenue taxes.

There shall be levied, collected, and paid upon all articles coming into the United States or its possessions from the Virgin Islands *the rates of duty and internal-revenue taxes which are required to be levied, collected, and paid upon like articles imported from foreign countries*: Provided, That all articles, the growth or product of, or manufactured in, such islands, from materials the growth or product of such islands or of the United States, or of both, or which do not contain foreign materials to the value of more than 20 per centum of their total value, upon which no drawback of customs duties has been allowed therein, coming into the United States from such islands shall be admitted free of duty. (Mar. 3, 1917, ch. 171, sec. 3, 39 Stat. 1133.)

- (b) Revenue Act of 1918, section 1304, 40 Stat. 1142, 26 USC 3350 (a), relating to taxes upon Virgin Islands products:

SEC. 3350. Shipments to the United States—(a) Taxes imposed in the United States.

Except as provided in section 3123, there shall be levied, collected, and paid in the United States, upon articles coming into the United States from the Virgin Islands, *a tax equal to the internal revenue tax imposed in the United States upon like articles of domestic manufacture.*

- (b) Exemption from tax imposed in the Virgin Islands.

Such articles shipped from such islands to the United States shall be exempt from the payment of any tax imposed by the internal revenue laws of such islands. (53 Stat. 404.)

- (c) Revenue Act of 1918, section 605, 40 Stat. 1108, 26 USC 2800 (a)(5), relating to rectified spirits:

- (5) Rectified spirits and wines.

In addition to the tax imposed by this chapter on distilled spirits and wines, there shall be levied, assessed, collected, and paid, a tax of 30 cents on each proof gallon and a proportionate tax at a like rate on all fractional parts of such proof gallon on all distilled spirits or wines rectified, purified, or refined in such manner, and on all mixtures produced in such manner, that the person so rectifying, purifying, refining, or mixing the same is a rectifier within the meaning of section 3254 (g): Provided, That this tax shall not apply to gin produced by the redistillation of a pure spirit over juniper berries and other aromatics.

- (d) RS 3244 (3), 26 USC 3254 (g), relating to rectifiers of distilled spirits:

- (g) Rectifier.

Every person who rectifies, purifies, or refines distilled spirits or wines by any process other than by original and continuous distillation from mash, wort, or wash, through continuous closed vessels and pipes, until the manufacture thereof is complete, and every wholesale or retail liquor dealer who has in his possession any still or leach tub, or who keeps any other apparatus for the purpose of refining in any manner distilled spirits, and every person who,



without rectifying, purifying, or refining distilled spirits, shall, by mixing such spirits, wine, or other liquor with any material, manufacture any spurious, imitation, or compound liquors for sale, under the name of whisky, brandy, gin, rum, wine, spirits, cordials, or wine bitters, or any other name, shall be regarded as a rectifier, and as being engaged in the business of rectifying: Provided, That nothing in this subsection or section 3250 (f)(1) shall be held to prohibit the purifying or refining of spirits in the course of original and continuous distillation through any material which will not remain incorporated with such spirits when the manufacture thereof is complete.

- (e) RS 3248, 26 USC 2800 (c), relating to time of attachment of tax on distilled spirits:

(c) Time of attachment.

The tax shall attach to distilled spirits, spirits, alcohol or alcoholic spirit, within the meaning of subsection (b) of section 2809 as soon as this substance is in existence as such, whether it be subsequently separated as pure or impure spirit, or be immediately, or at any subsequent time, transferred into any other substance, either in the process of original production or by any subsequent process.

- (f) Trade Agreement Act of June 12, 1934, 48 Stat. 943, 19 USC 1351:

SEC. 1351. Foreign-trade agreements—(a) Authority of President; modification of duties; altering import restrictions.

(a) For the purpose of expanding foreign markets for the products of the United States . . . the President, whenever he finds as a fact that any

existing duties or other import restrictions of the United States or any foreign country are unduly burdening and restricting the foreign trade of the United States and that the purpose above declared will be promoted by the means hereinafter specified, is authorized from time to time—

(1) To enter into foreign-trade agreements with foreign governments or instrumentalities thereof; and

(2) To proclaim such modifications of existing duties and other import restrictions, or such additional import restrictions, or such continuance, and for such minimum periods, of existing customs or excise treatment of any article covered by foreign-trade agreements, as are required or appropriate to carry out any foreign-trade agreement that the President has entered into hereunder. No proclamation shall be made increasing or decreasing by more than 50 per centum any existing rate of duty or transferring any article between the dutiable and free lists. The proclaimed duties and other import restrictions shall apply to articles the growth, produce, or manufacture of all foreign countries, whether imported directly, or indirectly: . . .

(g) Trade agreement between the United States and the United Kingdom, effective January 1, 1939, 54 Stat. 1897, TD 49753, articles XII and XIV:

#### ARTICLE XII

Articles the growth, produce or manufacture of any of the territories to which this Agreement applies on the part of his Majesty the King, enumerated and described in Schedule IV annexed to this Agreement, shall, on their importation into the

United States of America, from whatever place arriving, be exempt from ordinary customs duties other or higher than those set forth and provided for in the said Schedule IV, subject to the conditions therein set out. The said articles shall also be exempt from all other duties, taxes, fees, charges or exactions of any kind, imposed on or in connection with importation, in excess of those imposed on the day of the signature of this Agreement or required to be imposed thereafter under laws of the United States of America in force on the day of the signature of this Agreement.

#### ARTICLE XIV

The provisions of Article IX, Article X, Article XI and Article XII of this Agreement shall not prevent the imposition at any time on the importation of any article of a charge equivalent to an internal tax imposed in respect of a like domestic article or in respect of a commodity from which the imported article has been produced or manufactured in whole or in part.

- (h) Trade agreement between the United States and Haiti, effective June 3, 1935, 49 Stat. 3737, TD 47667, article II:

#### ARTICLE II

Articles the growth, produce or manufacture of the Republic of Haiti, enumerated and described in Schedule II annexed to this Agreement and made a part thereof, shall, on their importation into the United States of America, be exempt from ordinary customs duties in excess of those set forth in the said Schedule, and from all other duties, taxes, fees, charges, or exactions, imposed on or in connection with importation, in excess of those imposed or re-

quired to be imposed by laws of the United States of America in effect on the day of the signature of this Agreement.

- (i) 26 C.F.R. 1941 supp. 180.134 (a), relating to internal-revenue tax on Virgin Islands products:

(a) Distilled spirits. If the certificate is accompanied by a report of gauge made by an insular gauger and bears the insular gauger's certification, as prescribed in Sec. 180.99, showing that the spirits covered thereby were 100 degrees or more in proof at the time of withdrawal from the insular bonded warehouse, the internal revenue tax at the distilled spirits rate will be collected on the proof-gallon contents of the packages, or cases, regardless of the proof of the spirits at the time of their entry into the United States. If the certification of the insular gauger and the accompanying report of gauge show that the spirits were less than 100 degrees in proof at the time of withdrawal thereof from the insular bonded warehouse, the internal revenue tax at the distilled spirits rate will be collected on the wine-gallon contents of the packages or cases as determined by the customs gauger.

No. 11,168

IN THE  
**United States Circuit Court of Appeals**  
For the Ninth Circuit

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PARROTT & COMPANY (a corporation),

*Appellant,*

vs.

UNITED STATES OF AMERICA,

*Appellee.*

On Appeal from the District Court of the United States  
for the Northern District of California.

**BRIEF FOR THE UNITED STATES.**

---

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FILED

MAR 7 - 1946



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No. 11,168

IN THE

# United States Circuit Court of Appeals

For the Ninth Circuit

---

PARROTT & COMPANY (a corporation),	
	<i>Appellant,</i>
VS.	
UNITED STATES OF AMERICA,	
	<i>Appellee.</i>

On Appeal from the District Court of the United States  
for the Northern District of California.

## BRIEF FOR THE UNITED STATES.

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### OPINION BELOW.

No previous opinion in this case has been rendered.

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### JURISDICTION.

This appeal involves federal distilled spirits taxes. The taxes in dispute, totaling \$9,606.32, were paid on various dates from December 8, 1938, to October 29, 1941. (R. 16-18.) Claim for refund was filed on December 3, 1942 (R. 8), was rejected by notice dated September 16, 1943, thereafter was reconsidered on protest of claimant, and again rejected on October 6, 1943. (R. 9.) Within the time provided in Section

3772 of the Internal Revenue Code and on January 10, 1945, the taxpayer brought an action in the District Court for recovery of the taxes paid. (R. 2-14.) Jurisdiction was conferred on the District Court by Section 24, "Twentieth, of the Judicial Code. Motion to dismiss was filed March 24, 1945, and an order granting the motion was filed July 20, 1945. (R. 19.) Within three months and on September 4, 1945, a notice of appeal was filed (R. 20), pursuant to the provisions of Section 128 (a) of the Judicial Code, as amended.

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#### **QUESTIONS PRESENTED.**

1. Whether rum brought into the United States from the Virgin Islands is taxable under Section 600 of the Revenue Act of 1918, as amended, and Section 2800 of the Internal Revenue Code at a rate equal to the tax on like articles manufactured in the United States or at the rate imposed upon like articles imported from foreign countries.

2. Whether the rum was taxable under Section 600 of the Revenue Act of 1918, as amended, and Section 2800 (a) (5) of the Internal Revenue Code as a rectified product.

3. Whether the basic tax imposed on distilled spirits under Section 600 of the Revenue Act of 1918, as amended, and Section 2800 (a) (1) of the Internal Revenue Code was collectible on the wine gallons where at the time it is withdrawn from the customs warehouse the rum was 86 proof.

**STATUTES AND OTHER AUTHORITIES INVOLVED.**

The pertinent statutes and other authorities herein referred to will be found in the Appendix, *infra*, pages i-xi.

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**STATEMENT.**

This is a suit brought by the taxpayer seeking a refund of internal revenue taxes paid on distilled spirits which were brought into the United States from the Virgin Islands during the years 1938 to 1941. The Government filed a motion to dismiss on the grounds that the facts alleged in the complaint failed to state a cause of action, and the complaint shows upon its face that all taxes paid were legally and properly collected from the taxpayer. The Court below dismissed the complaint (R. 19), and the taxpayer has appealed from that order.

The complaint herein filed sets forth in detail Formulae 2, 7, 10, 11, and 12, in accordance with which the taxed rum was produced. Under each of the formulae the rum was mixed with some coloring matter or flavoring material, or blended with another kind of rum, as clearly appears from the formulae as alleged in paragraph V of the complaint. (R. 5-8.) The rates of taxes and the amounts collected are also a part of the complaint. (R. 14-18.)

Under some of the formulae the rum was distilled in a continuous column still at less than 190 proof, and some of the spirits were placed in charred oak

barrels for aging, and other of the same spirits were placed in reused barrels at over 100 degrees proof. After aging, these two spirits are mixed and the resultant product was reduced with distilled water to 86 proof after which it was filtered and bottled.

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### **SUMMARY OF ARGUMENT.**

Rum brought into the United States from the Virgin Islands is subject to taxes in a sum equal to the taxes payable on like articles manufactured in the United States, as provided by Section 3350 (a) of the Internal Revenue Code. This is the policy with respect to all insular possessions and it is not affected by any trade agreements with other countries. The rum in question was subject, as provided in Section 2800, Internal Revenue Code, as amended, to the rectifying tax of 30 cents per proof gallon and the basic distilled spirits tax of \$2.25, \$3 and \$4, the rate in effect at the time the rum was withdrawn from the warehouse. The rectifying tax applies because the spirits became spurious, imitation or compound liquors when mixed with the other materials described in the formulae. The proof gallon rate is never applicable where, as here, the rum was below proof when withdrawn.

**ARGUMENT.****I.**

**RUM BROUGHT INTO THE UNITED STATES FROM THE VIRGIN ISLANDS IS SUBJECT TO THE TAXES LEVIED BY SECTION 600 OF THE REVENUE ACT OF 1918, AS AMENDED, AND SECTION 2800 OF THE INTERNAL REVENUE CODE.**

In determining the issues in this case we must bear in mind the intent of Congress to establish and maintain a parity in regard to taxation between manufacturers in the Virgin Islands and those in the United States. This intent prevails with regard to all our insular possessions, as is shown by the following:

Hawaii. All the laws of the United States which are not locally inapplicable, shall have the same force and effect within the said Territory as elsewhere in the United States. Act of April 30, 1900, c. 339, 31 Stat. 141, Sec. 5.

Upon articles imported from Puerto Rico there is imposed a tax equal to the internal revenue tax imposed in the United States upon the like articles of merchandise of domestic manufacture. Act of April 12, 1900, c. 191, 31 Stat. 77, Sec. 3.

Upon articles imported from the Philippine Islands there is imposed a tax equal to the internal revenue tax imposed in the United States upon the like articles, goods, wares or merchandise of domestic manufacture. Act of October 3, 1913, c. 16, 38 Stat. 114, 192, Sec. IV C.

Upon articles imported from the Virgin Islands there is imposed a tax equal to the internal revenue tax imposed in the United States upon like articles.

Revenue Act of 1917, c. 63, 40 Stat. 300, Sec. 1000\*; Revenue Act of 1918, c. 18, 40 Stat. 1057, Sec. 1304.

The above citations show clearly the intent of Congress. All the laws of the United States not locally inapplicable have full force and effect in Hawaii. Because the laws of the United States are not applicable in the other island possessions a tax equal to the tax imposed upon like articles of domestic manufacture has been imposed upon imports from those islands by specific statutes, and the courts have so construed them. *Jordan v. Roche*, 228 U.S. 436; *United States v. Rathjen Bros.*, 137 F. (2d) 103; *Santoni & Co. v. Rafferty*, 10 F. (2d) 788 (C.C.A. 2d); *Bornn v. United States*, 61 C. Cls. 425, certiorari denied, 271 U.S. 684.

The provisions of Section 3 of the Virgin Islands Act of 1917 (Appendix, *infra*), that the taxes to be paid shall be rates required to be paid upon like articles imported from foreign countries are clearly in conflict, irreconcilable and inconsistent with the provisions of Section 1304 of the Revenue Act of 1918. The 1918 Act being the later is therefore controlling. *Posadas v. National City Bank*, 296 U.S. 497; *United States v. Chaflin*, 97 U.S. 546; *United States v. Tynen*, 11 Wall. 88; *United States v. Rathjen Bros.*, *supra*.

The Liquor Tax Administration Act, Section 329 (c) (Appendix, *infra*), makes Title III of the National Prohibition Act, and the provisions of the in-

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\*For the legislative history see H. Rep. No. 45, 65th Cong., 1st Sess., p. 10 (1939—1 Cum. Bull. (Part 2) 48).



ternal revenue laws relating to enforcement, applicable in the Virgin Islands.

Section 2800 (a) (1) of the Internal Revenue Code (Appendix, *infra*), approved February 10, 1939, expressly levies the tax upon the distiller and importer, and paragraph (a) (5) imposes in addition thereto the 30 cents per gallon rectifying tax. Paragraph (a) (4) (B) refers to Section 3350, Internal Revenue Code (Appendix, *infra*), for provisions with reference to tax on alcohol products coming from the Virgin Islands.

Section 3350 provides for "a tax equal to the internal revenue tax imposed in the United States upon like articles of domestic manufacture."

Trade agreements with foreign countries have no application to the possessions of the United States (*De Lima v. Bidwell*, 182 U.S. 1) and, therefore, have no bearing on this case. In any event, the taxing statutes, increasing the taxes, which are subsequently passed by Congress supersede such trade agreements unless Congress expressly expects them. In *United States v. Rathjen Bros.*, *supra*, the Court said (p. 105):

When the Congress enacted the statute providing that all *distilled spirits imported into the United States* should be subject to an internal revenue tax of \$2.25 per proof gallon it certainly must have intended to include imported rum regardless of the size of the containers and regardless of the country from which exported. If we were to hold that the involved merchandise is excepted

from the said statute by reason of the quoted provision of the Cuban Trade Agreement of 1934, we would read an exception into the statute, thereby nullifying that portion of the act levying an internal revenue tax on *all distilled spirits imported into the United States*. (Italics supplied.)

The purpose of the enactment of Section 3350 (a) of the Internal Revenue Code was obviously to provide for the payment of taxes on articles brought into the United States from the Virgin Islands in a sum equal to the taxes on like articles manufactured in the United States. This construction is clearly demonstrated if paragraphs (a) and (b) of this section are read together, for paragraph (a) provides for the payment of a tax equal to that imposed upon a domestic manufacturer, and paragraph (b) exempts such articles from the tax imposed by the internal revenue laws of the Virgin Islands when such articles are imported into the United States. To hold otherwise would place distilled spirits brought in from the Virgin Islands in a preferred class and make it possible to sell such products at a cheaper price than domestic products of like nature.

The taxpayer is asking the Court to apply the Virgin Islands Act of March 3, 1917, and those provisions of the different trade agreements most favorable to it. These agreements do not support the taxpayer in the relief sought. Article XI of the Haiti Reciprocal Trade Agreement of March 28, 1935, 49 Stat. (Part 2) 3737, provides:

Except as otherwise provided in the second paragraph of this Article, the provisions of this Agreement relating to the treatment to be accorded by the United States of America and the Republic of Haiti, respectively, to the commerce of the other country, shall not apply to \* \* \* the Virgin Islands, \* \* \*.

Article IV of the Agreement provides that the articles shall be exempt only from "all internal taxes \* \* \* other or higher than those payable on like articles of national origin \* \* \*". To the same effect is Article XIV of the Great Britain Reciprocal Trade Agreement of November 17, 1938, 54 Stat. (Part 2) 1897, 1903. Moreover, the Tariff Act of 1930, c. 497, 46 Stat. 590, Schedule 8, Par. 801 (b), provides:

The duties prescribed in Schedule 8 and imposed by Title I shall be in addition to the internal revenue taxes imposed under existing law, *or any subsequent Act.* (Italics supplied.)

Since there is no language in any of the trade agreements which would modify this provision of the Tariff Act it appears that imported rum is subject to the internal revenue taxes. This construction is in conformity with the interpretation which the Supreme Court placed upon the Act of April 12, 1900, c. 191, 31 Stat. 77 (commonly called the Foraker Act), applicable to Puerto Rico, in *Jordan v. Roche, supra*.

Paragraph 802 of the Tariff Act provides for a duty of \$5 per proof gallon which under the trade agreement with Great Britain has been reduced 50%,

thereby making the customs duty on distilled spirits \$2.50 per proof gallon.

Under the Revenue Act of 1943, c. 63, 58 Stat. 26, Sec. 302, the tax on distilled spirits was increased to \$9 per proof or wine gallon. If only \$2 could now be collected on spirits imported from foreign countries, in addition to the payment of the duty of \$2.50, the total amount of tax and duty on foreign spirits would be only \$4.50 per gallon which would place the competitive rate at about one-half of the price of our local manufactured products. Today all importers are required to pay \$9 per proof gallon, or \$9 per wine gallon when below proof, on distilled spirits products imported from foreign countries. Thus the taxpayer's contention leads to a result which is quite inconsistent with the Congressional purpose.

It must be concluded, therefore, that the rum in question was subject to the same taxes as articles of like nature manufactured in the United States.

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## II.

### **THE RUM DESCRIBED IN THE COMPLAINT WAS SUBJECT TO THE RECTIFYING TAX OF THIRTY CENTS PER GALLON.**

The rectifying tax is imposed by Section 2800 (a) (5), Internal Revenue Code, on the products of a manufacturer who is rectifier within the meaning of Section 3254, Internal Revenue Code. (Appendix, *infra*.) It makes no difference whether the manufacturer is regulated by our occupational tax laws or not,

the tax is nevertheless collectible on the article. The rectifying tax of 30 cents per gallon on the rum in question was properly and legally collected.

Products of rectification are defined in Section 2800 (a) (5), Internal Revenue Code, as "all distilled spirits or wines rectified, purified or refined in such manner, \* \* \* that the person so rectifying, purifying, refining or mixing the same is a rectifier within the meaning of section 3254 (g): \* \* \*". Section 3244 (g) of the Revised Statutes (which is the predecessor of Section 3254 (g)) was interpreted by the Circuit Court for the Middle District of Tennessee in *Michel v. Nunn*, 101 Fed. 423. That was an action against the Collector of Internal Revenue brought by the taxpayer to recover taxes exacted from the taxpayer as a rectifier of spirits where he had mixed whiskey with sugar and water and placed the resultant mixture in bottles on his shelf for sale. The Court emphasized the broadness of the statute by the use of the phrase "mixing with any material", as may be seen from the following quotation (p. 424):

Rev. St. Sec. 3244, subd. 3. Now, the statute thus enumerates classes who are actually engaged in modes of refining or rectifying, and after having classified in this way, for the purpose of ascertaining when persons are subject to this tax, the statute passes entirely away from persons actually engaged in any process of distillation or refining, by saying, "and every person who without rectifying," going entirely away from those who have been purifying or refining, to the statement, "every person who without rectifying, purifying

or refining distilled spirits." So there is here clearly the intent to include every person, the act passing to what may be called "compounding." Such persons are not rectifying, purifying, or refining, but compounding. "Shall by mixing such spirits, wine, or other liquor with any material," are the words of the statute; "with any material," not by mixing wines or liquors of one kind with another, but with "any material"; and thereby "manufacture any spurious, imitation, or compound liquors for sale, under the name of whiskey, brandy, gin, rum, wine, spirits, cordials, or wine bitters, or any other name, shall be regarded as a rectifier, and as being engaged in the business of rectifying." Now, it has not been asserted that that language, "by mixing the liquors with any material," has any technical or trade meaning, or that its meaning is other than in ordinary use, and, taking it in its ordinary use, in the popular sense, it certainly could not be said that, if it is mixed with either water or sugar or blackberry juice, it is not mixed with any material,—"any material." And it strikes me that an interpretation that would undertake to say that certain materials are within the statute, and other materials are not within it, when the statute itself uses the term "any material," would nullify the statute.

A similar broad interpretation was placed upon this statute by the District Court for the Southern District of New York in a forfeiture proceeding, *Quantity of Distilled Spirits*, 20 Fed. Cas. No. 107, where the Court construed the term "rectifier" with the following language (p. 108):

That the claimants were rectifiers of spirits is perfectly apparent. The eighteenth paragraph of the seventy-ninth section of the act of June 30th, 1864, as subsequently amended, defines what a rectifier is: "Every person, firm or corporation who rectifies, purifies, or refines distilled spirits or wines by any process, or who, by mixing distilled spirits or wines with any materials, manufactures any spurious, imitation or compound liquors for sale, under the name of whiskey, brandy, gin, rum, wine, spirits, or wine bitters, at any other name, shall be regarded as a rectifier." That is the definition the law gives of a rectifier. A rectifier is not merely a person who runs spirits through charcoal, but anyone who rectifies or purifies spirits in any manner whatever, or who makes any mixtures of spirits with anything else, and sells it under any name, is a rectifier.

Under Formula 2, aged rum made from sugar cane is withdrawn from charred oak barrels and "blended with white rum made from molasses". (R. 5.)

Under Formula 7, "7/10 of 1 percent of sugar caramel is added" to the rum. (R. 5.)

Under Formula 10, the rum made from molasses is placed into "newly charred oak barrels, and into reused oak barrels, from which all char has been removed, for ageing." After ageing, the rum from the "reused cooperage is mixed with rum from the new charred cooperage". (R. 6.)

Under Formula 11, the rum is treated with "Darco carbon in the proportion of 2.4 pounds Darco carbon per one hundred gallons of rum". (R. 7.)

Under Formula 12, the rum is treated with "Darco carbon in the proportion of 1.0 pound Darco carbon per one hundred gallons of rum". (R. 8.)

Applying the broad interpretation placed upon Section 3254 (g) in the cases above cited, there certainly can be no doubt that the rum made under Formulae 7, 11 and 12, which show a mixture with other substances, was rectified. Neither should there be any doubt that the rum made under Formulae 2 and 10 was rectified within the meaning of Section 3254 (g), unless it comes clearly within the exceptions as provided in Section 2801 (c) (1) of the Internal Revenue Code (Appendix, *infra*). This section provides that the tax shall not attach to the mixing and blending of wines,—

\* \* \* nor to blends made exclusively of two or more pure straight whiskies aged in wood for a period not less than four years and without the addition of coloring or flavoring matter or any other substance than pure water and if not reduced below ninety proof; \* \* \*.

and then only when compounded under the immediate supervision of a revenue officer in accordance with the Treasury regulations.

The rums described by the formulae set out in the complaint, on which the 30 cents rectifying tax was paid, do not come within the exceptions provided in Section 2801 of the Internal Revenue Code. It is our contention that these explicit exceptions as set out in the statute support the broad interpretation which the Courts have placed upon Section 3254 (g).



Section 3254 (g), Internal Revenue Code, which defines a rectifier does not limit the definition to a person who rectifies, purifies or refines distilled spirits, but after so defining a rectifier the statute includes others by this language:

\* \* \* and every person who, without rectifying, purifying, or refining distilled spirits, shall, by mixing such spirits, wine, or other liquor with any material, manufacture any spurious, imitation, or compound liquors for sale, under the name of whiskey, brandy, gin, rum, wine, \* \* \* or any other name, shall be regarded as a rectifier, \* \* \*

(26 U.S.C. 1940 ed., Sec. 3254.)

A rectified product under Section 2800 (a) (5) of the Internal Revenue Code is one which falls under the classification that will cause the manufacturer to "be regarded as a rectifier". In other words, the taxing statute is not limited to articles which are manufactured by "rectifiers" as such. The taxpayer's argument that the rum is not a rectified product within the meaning of the statute, because the taxpayer was not a resident rectifier, cannot be sustained.

In *Quantity of Distilled Spirits, supra*, the Court instructed the jury that under the evidence introduced at the trial the claimants were rectifiers. In arriving at this conclusion the Court quoted the statute and emphasized the broad language there used. In the case at bar the United States upon its motion to dismiss asked the District Court to rule that the rums manufactured under the formulae set out in the com-

plaint were rectified products within the meaning of the statute, and the lower Court has so held.

Under the wording of the statutes and their broad interpretation by the Courts, the rums in question were definitely rectified products and taxable as such. When distilled spirits are mixed "with any material" other than distilled water which is used in reducing the proof, the spirits become spurious, imitation, or compound liquors. The rums described in the complaint, having been mixed with other materials, as set out in the formulae, are clearly within the definition.

The taxpayer argues that the statutes relating to rectifiers within the United States have no application to it. This is true only with reference to the statutes which impose occupational taxes upon rectifiers. But no occupational taxes were collected from the taxpayer and none are involved in this suit. The rectifying tax of 30 cents per gallon here involved is an excise tax on the product, and is collectible regardless of whether the rum was produced by a licensed or an unlicensed rectifier. See *United States v. One Ford Coupe*, 272 U.S. 321, 328.

If the taxpayer's reasoning is accepted with respect to the statutes regarding rectifiers in the United States, then it may be said that the same reasoning should apply to distillers and, therefore, the basic production tax on distilled spirits brought into the United States is not collectible because the laws regulating distillers have no application to manufacturers outside the boundaries of the United States. Under

such anomalous reasoning, the United States has failed to tax distilled spirits brought into the United States from its possessions or even from foreign countries.

The taxpayer argues that prior to 1937, the rectifying tax was not collected by the Commissioner on distilled spirits brought from the Virgin Islands and for twenty-eight years the 1917 Act has been recognized as being applicable. By T. D. 4770, 1937—2 Cum. Bull. 568 (Appendix, *infra*), the Commissioner of Internal Revenue for the first time, by regulation, undertook to collect the rectifying taxes on distilled spirits brought in from the Virgin Islands.

In determining the time element the Court must keep in mind the fact that from 1919 to 1920 we had war prohibition in the United States (Sec. 1 of the Act of November 21, 1918, c. 212, 40 Stat. 1045), and from 1920 to December 5, 1933, we had national prohibition (National Prohibition Act, c. 85, 41 Stat. 305), and importation of distilled spirits from the Virgin Islands and foreign countries for beverage use was prohibited by Section 601 of the Revenue Act of 1918. (Appendix, *infra*.) During this fifteen-year period, therefore, it was unlawful to bring into the United States distilled spirits for beverage uses. The only importations permitted were for medicinal, food, and industrial uses. Very little, if any, rum was brought into the United States during that period, and the matter of considering the rectifying tax on such spirits was of little or no consequence.

The National Prohibition Act, and the supplemental Act of November 23, 1921, c. 134, 42 Stat. 222, were extended to the Virgin Islands by Section 3 of the latter Act.

In the Attorney General's Opinion of June 9, 1926, 35 Op. A.G. 63, cited by the taxpayer, only two questions were considered: Whether taxes could be collected in the Virgin Islands on the manufacture and sale of industrial alcohol which under the laws of the United States was tax exempt, and whether taxes collected in the United States on industrial alcohol produced in the Virgin Islands and brought into the United States should be covered into the Treasury of the United States. The taxing statutes were not considered by the Attorney General in a sense applicable to the case at bar.

However, after the effective date of the Twenty-first Amendment to the Constitution, and the repeal of the National Prohibition Act, December 5, 1933, the taxation and control of distilled spirits imported from foreign countries and the island possessions became a problem. By the Liquor Tax Administration Act, Section 329 (c), *supra*, Congress made Title III of the National Prohibition Act and the provisions of internal revenue laws relating to enforcement applicable in the Virgin Islands. This indicated clearly that the taxing of products of the Virgin Islands was intended to be assimilated to the domestic situation. Within a short period thereafter the Commissioner promulgated Treasury Decision 4770, approved October 25, 1937,

*supra*. Since under the circumstances it made slight practical difference whether or not the Treasury asserted the authority to collect any tax, there would be no reason for Congress to take any action in the matter. Accordingly there is no basis for spelling out a legislative confirmation of the applicability of any particular statute. It is clear that in the enactment of the Internal Revenue Code in Section 2800 (a) (4) (B), Congress made Section 3350 the applicable statute.

The cases cited by the taxpayer in its brief are not applicable because here there is no ambiguity in the statute (Section 1304 of the Revenue Act of 1918, c. 18, 40 Stat. 1057), and this case should be governed by the language of the statute and not by any previous inaction of the Commissioner.

In *Sterling Cider Co. v. Hassett*, 133 F. (2d) 590 (C.C.A. 1st), the appellant contended that apple cider manufactured by it did not come within the definition of apple wine, as defined in the regulations. In answer to this contention, the Court said (p. 595): "We are governed, however, not by the regulations but by the language of the statute", and the fact that the Commissioner did not collect taxes on cider sold by the farmers was not controlling.

The rectifying tax of 30 cents per gallon was properly collected on the rum in question.

## III.

THE BASIC DISTILLED SPIRITS TAX UNDER SECTION 600 OF THE REVENUE ACT OF 1918, AS AMENDED, AND SECTION 2800, INTERNAL REVENUE CODE, IS COLLECTIBLE ON THE WINE GALLONS WHEN BELOW PROOF, WHEN WITHDRAWN FROM BOND.

Section 2800 (a) (1) provides for the payment of the tax "on each proof gallon or wine gallon when below proof \* \* \* to be paid by the distiller or importer when withdrawn from bond." Section 3350 (a) of the Internal Revenue Code provides that the tax shall be "levied, collected, and paid in the United States".

In the case at bar we must look to the articles as of the dates on which they were withdrawn from the customs bonded warehouse; that is, as to the kinds of spirits, the proof of the spirits and the rates of tax. At the time of withdrawal from the customs warehouse the spirits were 86 proof, and therefore taxable on the wine gallons. The withdrawal dates are set out in the "Appendix" attached to the complaint (R. 16-18), and are subsequent to the dates on which the rum was brought into the United States.

The taxpayer contends that the tax should be on the proof rather than wine gallons because the rum as originally distilled was more than 100 proof and later reduced below proof with distilled water, thus bringing the spirits within Sections 180.98, 180.133 and 180.134 of Regulations 24. (Appendix, *infra*.) Under these regulations, it was necessary for the importer to file the report of the gauge and a certificate as provided by Section 180.99. (Appendix, *infra*.)

These regulations were not promulgated until June 16, 1941, and prior thereto there was no procedure whereby the Commissioner could determine the gauge of spirits brought from the Virgin Islands other than at the port of entry. As to all rum brought into the United States before June 16, 1941, the tax on wine gallons was the only proper basis. As to the rum brought in after that date there had been no gauge made as required by the regulations, and no certificates were furnished as required by the regulations. The only proper basis for the tax, therefore, was the wine gallon rate.

If the regulation is valid it has the force and effect of law. *Maryland Casualty Co. v. United States*, 251 U.S. 342; *United States v. Smull*, 236 U.S. 405; *United v. Grimaud*, 220 U.S. 506.

In *Douglas v. Commissioner*, 134 F. (2d) 762 (C.C.A. 8th), it was held that since the regulation was valid, the allowance of the deduction was, therefore, subject to the condition prescribed by the regulation.

In *Spencer, Kellog & Sons v. United States*, 13 Ct. Cust. App. 612, it was held that (p. 616):

\* \* \* the regulations requiring notice of intent to export are mandatory and compliance therewith is a condition precedent to the right of the appellant to recover under the drawback provisions. Such regulations may not be disregarded and proof of exportation made in some other manner than that required by them.

In *Nestle's Food Co. v. United States*, 16 Ct. Cust. App. 451, the Court cites the *Spencer* case, *supra*, with approval and holds that compliance with the

regulations is a condition precedent to the right of the plaintiff to recover under the drawback provisions. See also *Powell v. United States*, 135 Fed. 881 (C.C. W.D.N.Y.); *Commissioner v. Krein Chain Co.*, 72 F. (2d) 424 (C.C.A. 6th).

Distilled spirits of domestic manufacture are produced at over 100 proof, but if they are below proof when withdrawn from bond the tax is payable on the wine gallons as provided by Treasury Regulations 26 (Code of Federal Regulations, 1940 Supp., Title 26):

Sec. 186.115. *Spirits below proof.* When spirits are below proof the tax is levied on each wine gallon or fractional part thereof. For example: In case of a package of spirits, when the loss is not excessive, if the contents are found to be 44.55 wine gallons, 44.11 proof gallons the tax will be computed on 44.5 gallons.

In *United States v. Rathjen Bros.*, *supra*, rum was imported into the United States from Cuba on May 11, 1938, and was withdrawn from the warehouse on July 6 and July 14, 1938. Under the Liquor Taxing Act of 1934, c. 1, 46 Stat. 313, the tax was \$2, and under Section 710 of the Revenue Act of 1938, c. 289, 52 Stat. 447, effective July 1, 1938, the tax was increased to \$2.25. In determining the amount of tax payable on the rum, the Court said (p. 104):

It is clear that on July 6 and July 14, 1938, the dates upon which the involved merchandise was withdrawn from warehouse, the revenue laws provided that *all distilled spirits* produced in or imported into the United States *when withdrawn from warehouse* were subject to a tax of \$2.25 per proof gallon. (Italics supplied.)



It would seem clear that the date on which the articles are withdrawn from the warehouse governs. At the time the rum, involved in this suit, was withdrawn from the warehouse it was 86 proof, and being below proof it was taxable on the wine gallons at the rates collected thereon.

The taxes on the rum were payable upon the quantity of distilled spirits imported whether placed in a customs warehouse or not. *Louisville Public Warehouse Co. v. Collector of Customs*, 49 Fed. 561 (C.C.A. 6th). In the instant case the quantity of rum did not change between the dates of importation and the dates of removal from the customs warehouse. The amount of the tax as to the number of gallons of spirits imported was not affected by the fact that the rum was placed in a customs warehouse. If the rum had not been warehoused the rate of tax which was in effect on the day the rum was imported would be the rate payable.

However, it appears that the last three items under Warehouse entry 964, December 5, 1938 (R. 16), and all items, except the first five under Warehouse entry 4623, June 3, 1940 (R. 16), were imported or brought into the United States prior to June 30, 1940, and were withdrawn from the bonded warehouse after June 30, 1940. The rate of tax through June 30, 1940, was \$2.25 on each proof gallon or wine gallon when below proof, and subsequent to June 30, 1940, the rate of tax was \$3 on each proof gallon or wine gallon when below proof, as provided by Section 213 of the Revenue Act of 1940, c. 419, 54 Stat. 516. The Commissioner collected \$3 per wine gallon as provided by the Reve-

nue Act of 1940. That was the rate of tax which was in effect at the time the rum was withdrawn from the warehouse. It is respectfully submitted that the rate of tax which was in effect at the time the rum was withdrawn was the controlling rate rather than the rate when the rum arrived in the United States.

There should be no question about the correctness of this interpretation by the Commissioner, because the Revenue Act of 1940 provided for a floor tax of seventy-five cents on all distilled spirits on which \$2.25 had been paid. Therefore, if \$2.25 had previously been paid on the rum in question an additional seventy-five cents per gallon would have been payable thereon.

The taxpayer's argument that the rum should have been taxed at the proof gallon rate is based on the theory that all distilled spirits of domestic manufacture are taxed on the proof gallon; such, however, is not the case. Spirits which are placed in a bonded warehouse presumably at 100 proof are not taxed until such spirits are removed from bond. Immediately prior to removal, or upon removal, the spirits are regauged, at which time the wine gallons, together with the proof content, are determined. If the proof of the spirits is below 100, the tax is collected on the wine gallons. The fact that the spirits were originally manufactured at over 100 proof is not a factor to be considered.

The tax is levied upon the product and not upon the process; therefore, the process by which the imported rum was manufactured is not a factor to be considered in this case. In *Louisville Public Warehouse Co. v. Collector of Customs, supra*, the conten-

tion was made that the tax should be on proof gallons and not on wine gallons, but the Court held the assessment on the wine gallons to be proper. In that case the spirits were manufactured in the United States, exported and reimported into the United States.

It is respectfully submitted that the basic distilled spirits tax was payable on the wine gallons.

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### CONCLUSION.

The formulae alleged in the complaint show that the rums were rectified products and the alleged taxes collected by the Commissioner were those provided by law. The complaint, therefore, shows upon its face that the taxpayer is not entitled to refund. The decision of the Court below should be affirmed.

Dated, March 4, 1946.

Respectfully submitted,

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**(Appendix Follows.)**



## **Appendix.**



## Appendix

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### Internal Revenue Code:

#### Sec. 2800. TAX.

##### (a) *Rate.*

(1) *Distilled Spirits Generally.*—There shall be levied and collected on all distilled spirits (except brandy) in bond or produced in or imported into the United States as internal revenue tax at the rate of \$2.25 (and on brandy at the rate of \$2.00) on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon, to be paid by the distiller or importer when withdrawn from bond.

(2) *Products of Distillation Containing Distilled Spirits.*—All products of distillation, by whatever name known, which contain distilled spirits or alcohol, on which the tax imposed by law has not been paid, shall be considered and taxed as distilled spirits.

(3) *Imported Perfumes Containing Distilled Spirits.*—There shall be levied and collected upon all perfumes imported into the United States containing distilled spirits, a tax of \$2.25 per wine gallon, and a proportionate tax at a like rate on all fractional parts of such wine gallon. Such tax shall be collected by the collector of customs and deposited as internal revenue collections, under such rules and regulations as the Commissioner, with the approval of the Secretary, may prescribe.

(4) *Alcoholic Compounds from Puerto Rico, Virgin Islands and Philippines.*—

(A) *Puerto Rico*.—Except as provided in section 3123, upon bay rum, or any article containing alcohol, brought from Puerto Rico into the United States for consumption or sale there shall be paid a tax on the spirits contained therein at the rate imposed on distilled spirits produced in the United States, to be collected at the port of entry by the collector of internal revenue of the district in which the port is located. The Commissioner, with the approval of the Secretary, is authorized to make such rules and regulations as may be necessary to carry this paragraph into effect.

(B) *Virgin Islands and Philippines*.—For provisions relating to tax on alcoholic compounds from Virgin Islands and Philippines, see sections 3350 and 3340.

(5) *Rectified Spirits and Wines*.—In addition to the tax imposed by this chapter on distilled spirits and wines, there shall be levied, assessed, collected, and paid, a tax of 30 cents on each proof gallon and a proportionate tax at a like rate on all fractional parts of such proof gallon on all distilled spirits or wines rectified, purified, or refined in such manner, and on all mixtures produced in such manner, that the person so rectifying, purifying, refining, or mixing the same is a rectifier within the meaning of section 3254 (g): *Provided*. That this tax shall not apply to gin produced by the redistillation of a pure spirit over juniper berries and other aromatics. \* \* \*

(26 U.S.C. 1940 ed., Sec. 2800.)



## Sec. 2801. RECTIFIED SPIRITS.

(a) *Rate of Tax.*—

For rate of tax, see section 2800 (a) (5).

(b) *Proof and Volume.*—When the process of rectification is completed and the taxes prescribed by section 2800 (a) (5) have been paid, it shall be unlawful for the rectifier or other dealer to reduce in proof or increase in volume such spirits or wine by the addition of water or other substance; nothing herein contained shall, however, prevent a rectifier from using again in the process of rectification spirits already rectified and upon which the taxes have theretofore been paid.

(c) *Exemption From Tax.*—

(1) *Cordials and Liqueurs.*—The taxes imposed by section 2800 (a) (5) shall not attach to cordials or liqueurs on which a tax is imposed and paid under paragraph (1) or (2) of section 3030 (a), nor to the mixing and blending of wines, where such blending is for the sole purpose of perfecting such wines according to commercial standards, nor to blends made exclusively of two or more pure straight whiskies aged in wood for a period not less than four years and without the addition of coloring or flavoring matter or any other substance than pure water and if not reduced below ninety proof; nor to blends made exclusively of two or more pure fruit brandies distilled from the same kind of fruit, aged in wood for a period not less than two years and without the addition of coloring or flavoring matter or any other substance than pure water

1940, c. 737, 54 Stat. 974, and to \$4 by Section 533 of the Revenue Act of 1941, c. 412, 55 Stat. 687.

Revenue Act of 1918, c. 18, 40 Stat. 1057:

Sec. 601. That no distilled spirits produced after October 3, 1917, shall be imported into the United States from any foreign country, or from the Virgin Islands (unless produced from products the growth of such islands, and not then into any State or Territory or District of the United States in which the manufacture or sale of intoxicating liquor is prohibited), or from Porto Rico, or the Philippine Islands. Under such rules, regulations, and bonds as the Secretary may prescribe, the provisions of this section shall not apply to distilled spirits imported for other than (1) beverage purposes or (2) use in the manufacture or production of any article used or intended for use as a beverage.

Act of March 3, 1917, c. 171, 39 Stat. 1132:

Sec. 3. That on and after the passage of this Act there shall be levied, collected, and paid upon all articles coming into the United States or its possessions, from the West Indian Islands ceded to the United States by Denmark [Virgin Islands], the rates of duty and internal-revenue taxes which are required to be levied, collected, and paid upon like articles imported from foreign countries: *Provided*. That all articles, the growth or product of, or manufactured in such islands from materials the growth or product of such islands or of the United States or of both, or which do not contain foreign materials to the value of more than twenty per centum of their total value, upon which no drawback of customs

duties has been allowed therein, coming into the United States from such islands shall hereafter be admitted free of duty.

(48 U.S.C. 1940 ed., Sec. 1394.)

Liquor Tax Administration Act, c. 830, 49 Stat. 1939:

Sec. 329:

\* \* \* \* \*

(c) Title III of the National Prohibition Act, as amended, and all provisions of the internal revenue laws relating to the enforcement thereof, are hereby extended to and made applicable to Puerto Rico and the Virgin Islands, from and after August 27, 1935. The respective Insular Governments shall advance to the Treasury of the United States such funds as may be required from time to time by the Secretary of the Treasury for the purpose of defraying all expenses incurred by the Treasury Department in connection with the enforcement in Puerto Rico and the Virgin Islands of the said Title III and regulations promulgated thereunder. The funds so advanced shall be deposited in a separate trust fund in the Treasury of the United States and shall be available to the Treasury Department for the purposes of this subsection.

Treasury Regulations 24 (1941 ed.):

Sec. 180.98. *Regauge*.—Distilled spirits withdrawn from insular bonded warehouses for bottling without rectification or for rectification and bottling and shipment to the United States may be gauged at the time of withdrawal by an insular gauger. A report of gauge shall be prepared

by the insular gauger showing the name of the distiller, the serial number, the proof of the spirits, and the wine and proof gallon contents of each package gauged. The report of gauge shall be attached to the certificate prescribed in section 180.99.

Sec. 180.99. *Certificate*.—Every person bringing liquors or articles under these regulations into the United States from the Virgin Islands, except tourists, shall obtain a certificate in the English language from the manufacturer for each shipment showing (1) the name and address of the consignee; (2) the kind and brand name; (3) the quantity thereof as follows:

(a) If distilled spirits, the wine and proof gallons.

(b) If fermented liquors, the gallons, liquid measure, and the per centum of alcohol by volume.

(c) If articles, the kind, quantity and proof of the liquors used therein.

(4) the number and date of the approved formula; (5) a declaration that it has been manufactured in accordance with the formula; (6) the name and address of the person filing such formula, and (7) a certification by the insular gauger that the spirits covered by such certificate were or were not regauged by him when withdrawn from the insular bonded warehouse and, if regauged, were at that time at the proofs indicated on the attached report of gauge. The consignee shall file the certificate and report of gauge with the collector of customs at the port of entry, as provided in section 180.133.

Sec. 180.133. *Conditions*.—The importer shall file the report of gauge provided for in section 180.98 and the certificate provided for in section 180.99 with the collector of customs at the port of entry in the United States.

Sec. 180.134. *Action by collector of customs*.—The collector of customs will direct the proper customs gauger to determine the taxable quantity of liquors contained in the consignment by regauge or inspection and report the result thereof to the collector of customs. Upon receipt of such report the collector of customs will refer to the approved formula covering the product to determine the rate of internal revenue tax applicable thereto. When the rate of tax applicable to the product has been ascertained, the tax due on the consignment will be determined in the following manner:

(a) *Distilled spirits*.—If the certificate is accompanied by a report of gauge made by an insular gauger and bears the insular gauger's certification, as prescribed in section 180.99, showing that the spirits covered thereby were 100 degrees or more in proof at the time of withdrawal from the insular bonded warehouse, the internal revenue tax at the distilled spirits rate will be collected on the proof-gallon contents of the packages, or cases, regardless of the proof of the spirits at the time of their entry into the United States. If the certification of the insular gauger and the accompanying report of gauge show that the spirits were less than 100 degrees in proof at the time of withdrawal thereof from the insular bonded warehouse, the internal revenue tax at the distilled spirits rate will be collected on the wine-gallon contents of the

packages or cases as determined by the customs gauger. If the certificate does not bear the certification of the insular gauger and is not accompanied by a report of gauge made by an insular gauger showing the proof of the spirits at the time of their withdrawal from the insular bonded warehouse, the proof of the spirits at the time of regauge or inspection at the port of entry in the United States will be the basis for determining the internal revenue tax due thereon, i.e., if the spirits are less than 100 degrees in proof, the distilled spirits tax will be collected on the wine gallons, whereas if the spirits are 100 degrees or more in proof, the distilled spirits tax will be collected on the proof gallons. The rectification tax on taxable rectified spirits will be collected on the proof gallons contained in the consignment regardless of the proof of the spirits at the time of their withdrawal from the insular bonded warehouse or at the time of their entry into the United States.

(b) *Fermented liquor.*—(1) *Beer.*—If the certificate covers beer, the fermented malt liquor tax will be collected on the basis of the number of barrels of 31 gallons each, or fractional parts thereof, contained in the shipment.

(2) *Wine.*—If the certificate covers wine, the wine tax will be collected at the rates imposed by section 3030, Internal Revenue Code, as amended.

(c) *Articles.*—Where articles contain liquors, the tax will be collected at the rates prescribed by law on the liquor contained therein as shown by the certificate. (\* \* \*; Secs. 2800(a)(1), 2800(a)(4)(A), 2800(a)(5), 3030, 3150(a), I.R.C.)

Treasury Regulations 26 (Code of Federal Regulations, 1940 Supp., Title 26):

Sec. 186.115. *Spirits below proof*. When spirits are below proof the tax is levied on each wine gallon or fractional part thereof. For example: In case of a package of spirits, when the loss is not excessive, if the contents are found to be 44.55 wine gallons, 44.11 proof gallons, the tax will be computed on 44.5 gallons.

T. D. 4770, 1937-2 Cum. Bull. 568:

The Liquor Taxing Act of 1934, approved January 11, 1934 (U.S.C., 1934 ed., Title 26, sections 1150 *et seq.*, 1300 *et seq.*, and 1330 *et seq.*), as amended by the Liquor Tax Administration Act of June 26, 1936 (U.S.C., 1934 ed., Supp. II, Title 26, sec. 1300 (a) (1) and (2)), imposed taxes at various rates upon distilled spirits, wines, liqueurs and cordials, and fermented malt liquors. Rectification tax on rectified distilled spirits or wines at the rate of 30 cents per proof gallon is also collectible because of the provisions of the Third subsection of section 3244, Revised Statutes, as amended (U.S.C., 1934 ed., Title 26, sec. 1398 (f)), and the provisions of section 605 of the Revenue Act of 1918, as amended (U.S.C., 1934 ed., Title 26, sec. 1150 (a) (6)), if the product so rectified would be subject to that tax if manufactured in the United States.





No. 11,168

United States  
Circuit Court of Appeals  
For the Ninth Circuit

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PARROTT & COMPANY, a corporation, *Appellant*

VS.

UNITED STATES OF AMERICA, *Appellee*

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Upon Appeal from the District Court of the United States for  
the Northern District of California, Southern Division,  
before Judges Denman, Healy and Bone.

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Appellant's Supplemental Brief

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**FILED**

**JUN 3 - 1946**

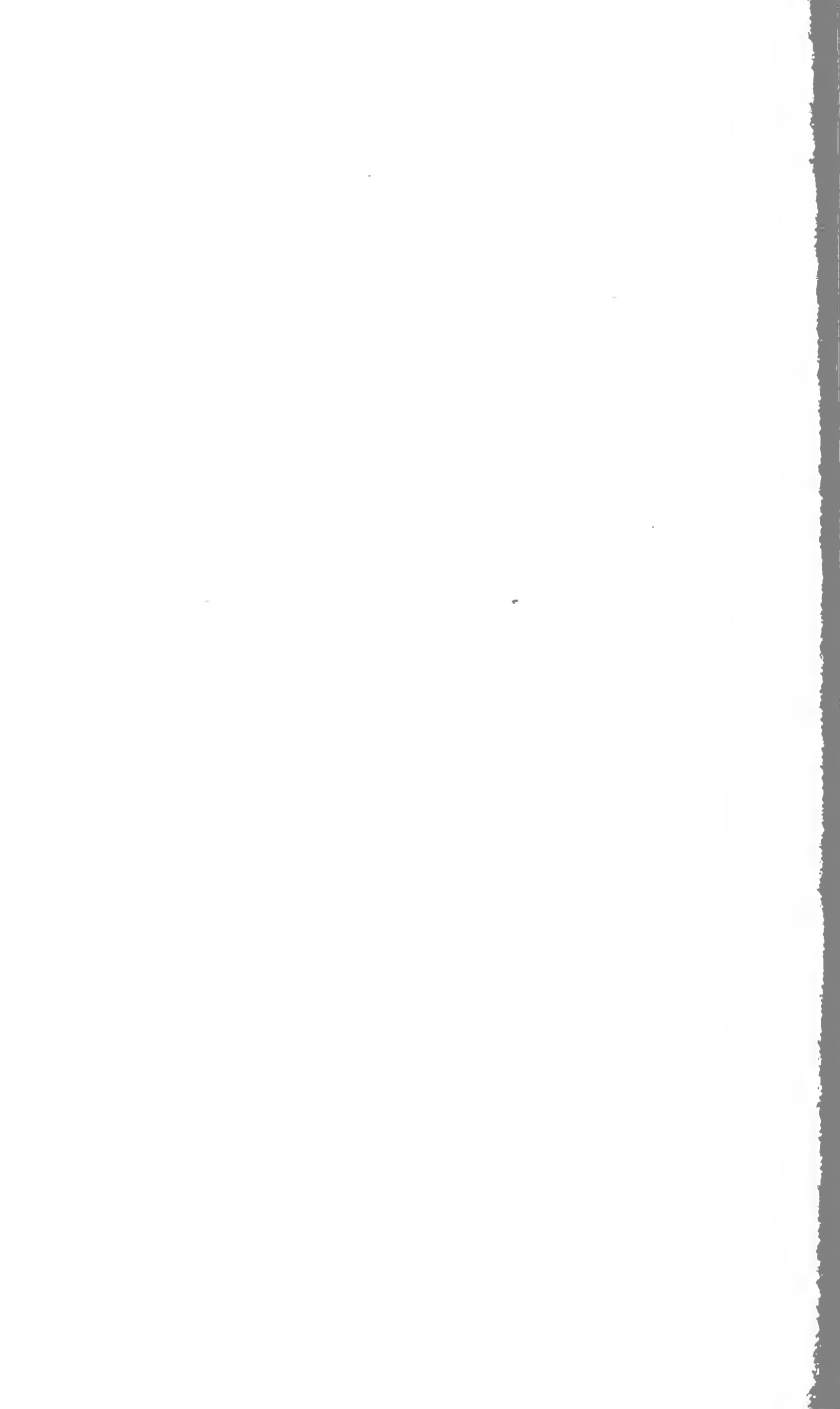
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**Appellant's Supplemental Brief**

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By permission of the court, this supplemental brief is filed, its purpose being to cite authorities and regulations which are not covered by appellant's opening brief; also, to refer to contentions made by counsel during argument. The numerical citations below, such as 190.157, refer to the 1940 Supplement of the Code of Federal Regulations, title 26.

## I) RECTIFICATION TAX

Rectifiers pay an occupational tax (190.157) and can only use liquors that have been previously tax-paid (190.202). While still in bond, i.e., before being tax-paid, "distilled spirits of the same kind, differing only in proof, . . . may be mingled together" (188.45). Also, while in a rectifying plant, necessarily after payment of the distilled spirits tax, homogenous spirits may be mixed or mingled without incurring the rectification tax (190.351). Therefore, if the rum described in formula 10 (R 6) had been produced in the United States it would not have been "rectified." See also *US v. Thirty-two Barrels*, 5 F 188, stating (190):

A rectifier is one who changes liquors by adding to them or compounding them or rectifying them; and yet the courts have held, under the statute defining what a rectifier is, that the mere addition of water to his spirits would not make him a rectifier, or the mixing of certain spirits of the same character, if they were under a certain age, would not be rectification.

A complete statement as to the scope of the rectification statute is found in a ruling by the Commissioner of Internal Revenue, dated Sept. 16, 1869, shortly after the initial enactment of this statute in 1868. It is published in 10 Int. Rev. Record 120, and appears in the appendix hereto.

## II) DISTILLED SPIRITS TAX

a) *Insular possessions*: Taxation of spirits from an insular possession was first the subject of legislation in



the Foraker Act of April 2, 1900, relating to Puerto Rico and specifying (as does 26 USC 3350 relied upon by the appellee here) that upon arrival in the United States products of Puerto Rico should pay a tax:

equal to the internal-revenue tax imposed in the United States upon the like articles of domestic manufacture.

At the same time, the statute RS 3251, contained the prototype of section 2800 (a) (1), which, as amended, levied an internal-revenue tax on distilled spirits of \$1.10 per proof gallon *or wine gallon when below proof*.

The Commissioner of Internal Revenue in Treasury Decision 404 of August 15, 1901 considered the application of the relevant statutes taxing domestic distilled spirits and of the Foraker Act with regard to Puerto Rican bay rum and held:

. . . bay rum, *if produced in this country*, either by original distillation or by compounding with non-tax paid spirits, would be subject to tax, *and according to the quantity of spirits contained* therein; and it seems equally clear that this tax would, under the provisions of section 3 (Foraker Act) attach to like spirits of Puerto Rican manufacture coming into the United States.

The Supreme Court passed upon the subject in *Jordan v. Roche*, 228 US 436, when it held that the Foraker Act required taxation of Puerto Rican bay rum upon arrival in the United States as "distilled spirits" because the distilled spirits tax was levied upon articles (p 445):

\* \* \* according to their alcoholic content under the generic name of distilled spirits.

Also, the court held that an act of February 4, 1909, specifically levying a tax upon Puerto Rican bay rum at \$1.10 per proof gallon was (p 445):

a more explicit expression of the purpose of the prior law made necessary by judicial construction of that law.

In *Bornn v. US*, 61 Ct. Cl. 425, *Jordan v. Roche, supra*, was reviewed, the court stating that it was there held that: the purpose of the Foraker Act of April 12, 1900, 31 Stat. 77, was to subject Puerto Rican articles to the internal-revenue laws of the United States *and that under these laws articles are taxed* not by their commercial names or uses but *according to their alcohol content* under the generic name of "distilled spirits"  
 . . .

Current statutes relating to the products of Puerto Rico, the Philippine Islands and the Virgin Islands are found in 26 USC, sections 2800 (a) (4), 3340 and 3350. These statutes have been construed by the Treasury as requiring taxation upon the alcoholic content of liquors. See 26 Code Fed. Reg., 1941 Supp., sections 180.60, 180.46 and 180.94, stating that such articles are:

subject to a tax *equal to* the internal revenue tax imposed *upon the production* in the United States of like liquors.

Also, articles other than liquors which contain distilled spirits (180.2) are subject, under sections 180.60, 180.46 and 180.94, to:

*tax upon the liquors contained therein* at the rates imposed in the United States *on like liquors* of domestic production.

b) *Taxation of like domestic articles*: The Revenue Act of 1918, 26 USC 3350, states that Virgin Islands products upon coming into the United States shall pay:

a tax equal to the internal revenue tax imposed in the United States upon like articles of domestic manufacture.

Here, in assessing the rectification tax, appellee obviously determined that this rum was a "like article" to domestic rum produced in the same manner as the Virgin Islands rum was produced. In other words, appellee looked to the method of production in order to determine whether the rum had been rectified. Therefore the method of production should likewise be followed in determining the amount of the distilled spirits tax.

The alleged facts in their simplest form are that this rum (R 4):

\* \* \* had been first distilled at over 100 proof and later by the addition of water was reduced to less than 100 proof.

For the purpose of demonstrating appellant's contention, reference is made to the further fact that the rum produced by formulas 3 and 5 (which are not set forth in the complaint) was of 90 proof upon arrival in the United States or upon withdrawal from customs warehouse (see scheduled data, R 16-8, column 5, and explanation of this schedule, R 15). Therefore the taxable status of the rum identified as having been produced under formulas 3 and 5 is to be determined by reference to domestic rum which likewise was "first distilled at over 100 proof and later by the addition of water was reduced to less than 100 proof," namely to 90 proof.

That the tax on such rum made in the United States would be on the proof and not the wine gallon basis is readily and conclusively demonstrated by reference to the following sections appearing in 26 CFR, 1940 Supplement:

The distilled spirits tax would have attached as soon as the rum of over 100 proof came into existence (183.257) and the distiller would have been liable for its payment (183.259).

At this point the distiller had two choices; namely, to withdraw from warehouse with tax payment upon the proof gallon basis, or to reduce the rum to not less than 90 proof by the addition of distilled water. See section 186.135, reading as follows:

186.135 Reduction in proof on warehouse premises. Distilled spirits contained in distillers' original packages may be reduced in strength to a proof of not less than 90 degrees *after having been gauged for withdrawal from the internal revenue bonded warehouse*, and after having been removed from the warehouse but before removal from the premises, or after they have been removed from the premises tax-paid and are still in the possession of the proprietor at his free warehouse.

As is shown by this regulation, the addition of water would have occurred *after* the rum had "been gauged for withdrawal from bonded warehouse," in other words, after the taxable quantity had been ascertained.

Thus, by a reference only to rums of formulas 3 and 5, which are 90 proof, and to the regulations cited above, it is demonstrated that the tax "equal to the internal revenue tax imposed in the United States upon *like* articles

of domestic manufacture" (26 USC 3350) is a tax levied upon the proof gallon and not the wine gallon.

The schedule attached to the complaint (R 16-8) does not set forth any amounts due appellant with regard to this proof v. wine gallon issue as to the rum covered by warehouse entries 359 and 546, and produced under formulas 5, 10, 11 and 12. This is because the Commissioner of Internal Revenue refunded the amount thus due appellant upon the filing of claims after tax on the wine gallon basis had been paid to the collector. Therefore, appellant's cause of action extends only to the rum covered by warehouse entries 964, 4623, 4790 and 5748, and produced by formulas 2, 3, 4, 5, 6 and 7 (R 16-8).

As is shown above, the rum covered by formulas 3 and 5 was of 90 proof and for reasons stated was taxable upon the proof gallon basis. Therefore the only additional rum involved in this point is that covered by formulas 2, 4, 6 and 7, which, as alleged in paragraph II (R 4), was likewise:

first distilled at over 100 proof and later by the addition of water was reduced to less than 100 proof.

Such rum when produced in the United States at over 100 proof could have been tax-paid upon that basis or, alternatively, as described above, could have been reduced in proof but not to less than 90 *while in bond* with tax payment upon the proof gallon basis. Therefore any reduction below 90 (i.e. to 86) would necessarily have been carried on in a rectifying plant under authority of 190.346, but without incurring the rectification tax (190.353). See also *US v. Thirty-two barrels, supra*, holding that addition of water does not result in rectifying-tax liability.

Further, as the distilled spirits tax must be paid *upon withdrawal* from bonded warehouse (26 USC 2800 (a) (1), and as only tax-paid spirits can be received in a rectifying plant (190.168), it follows that the reduction to 86 proof would have taken place *after* withdrawal from warehouse. Consequently, appellant's allegations also stated a cause of action with respect to the remaining rum covered by formulas 2, 4, 6 and 7.

### III) COMMENTS UPON APPELLEE'S BRIEF

At page 8 appellee states that the purpose of enactment of section 3350 (a) was to provide for payment of taxes on articles brought into the United States from the Virgin Islands:

in a sum equal to the taxes on like articles manufactured in the United States.

This is also appellant's contention, but the collector did not so assess, for he not only exacted a rectifying tax equal to that collected in the United States, but also collected a larger sum than would have been assessed had the rum been produced in the United States under like circumstances. To illustrate: The tax in the case of the 86 proof rum covered by formula 7 (warehouse entry 4790) was 30 cents per proof gallon plus \$3 per wine gallon, with the following comparative results:

Assessed tax on each 4 quarts Virgin Island rum		Tax in the United States on 4 quarts of rectified rum	
Rectification—30¢ x .86 of 1 gallon .....	\$ .258	Rectification—30¢ x .86 of 1 gallon .....	\$ .258
Distilled spirits—\$3 x 1 gallon .....	3.00	Distilled spirits—\$3 x .86 of 1 gallon.....	2.580
Total .....	\$3.258	Total .....	\$2.838

On page 20 appellee argues that the tax should be determined with regard to the condition of the Virgin Islands rum at the time it was:

withdrawn from the customs bonded warehouse; that is, as to the kinds of spirits, *the proof of the spirits* and the rates of tax. At the time of withdrawal from the customs bonded warehouse the spirits were 86 proof, and therefore taxable on the wine gallons.

This argument does not accord with the statute (26 USC 3350) which requires equality with the amount of tax assessed on like domestic articles. Also, it does not accord with the present regulations, which authorize taxation according to method of production in the Virgin Islands. Further, a patent weakness of the contention is demonstrated by reference to the fact that Virgin Islands merchandise, including rum, is frequently tax-paid immediately upon arrival in the United States *and without being placed in customs bonded warehouse*. Therefore, adoption of such a rule could lead only to confusion.

Appellee's counsel also cited 26 CFR, 1940 Supp., sec. 186.155 (R 22), as showing that if underproof spirits are withdrawn from bond the tax is levied upon the wine-gallon basis, but he does not point out that there is an exception to this rule; namely, if a distiller chooses to reduce overproof spirits to as low as 90 proof prior to withdrawal from bonded warehouse, he may do so and still pay tax upon the proof-gallon rather than the wine-gallon basis. See sec. 186.135 *supra*, permitting reduction in proof to not less than 90 prior to tax payment *but after being gauged for withdrawal from bonded warehouse*.

The regulation cited by appellee (186.115) merely deals with gauging, and as shown by its own terms, *is directed toward cases where a loss of proof occurs in bonded warehouse*. Distillers frequently reduce whisky and other spirits to exactly 100 proof under authority of section 186.135 for the purpose of withdrawal and sale at that proof. However, if the spirits remain in warehouse for more than 30 days after gauging they must be regauged (186.68). Consequently, if during this time a reduction in proof takes place by evaporation of alcohol, the regulation cited by appellee (186.115) becomes operative.

Appellant's contention here can be further demonstrated by reference to ordinary business practice. Inasmuch as distillers and other persons are permitted by regulations cited above to manipulate distilled spirits in such a manner as to entitle them to taxation upon the proof-gallon basis, it seems ridiculous to assume that any such person would produce spirits at overproof and then reduce those spirits to 90 proof *prior* to ascertainment of the amount of tax, when such a reduction can be accomplished after tax ascertainment by addition of water and without incurring further tax liability. In other words, no prudent person would pay the distilled spirits tax (now \$9 per gallon) on *water*. In this connection attention is called to section 1963 (4), Cal. Code of Civil Procedure, stating that it is presumed "That a person takes ordinary care of his own concerns" although the presumption may be controverted by evidence.

On pages 21-2 appellee cites several decisions holding non-compliance with mandatory regulations to be a bar to relief. Those cases are based upon the principle that when Congress provides that specific rights may be ob-



tained under regulations to be prescribed, compliance with those regulations is a condition precedent to obtaining of the right. The rule, however, is different as to regulations issued under general rather than specific authority. Then, regardless of what their effect may be when a taxpayer is dealing with administrative officers, a litigant can obtain rights granted by statute upon establishing in court that his case comes within the terms of the statute, even though he has not complied with administrative regulations. See *US v. Post Fish Co.*, 5 Ct. Cust. Appls. 130, 134; also *US v. Morris & American Express Co.*, 3 Ct. Cust. Appls. 146, stating (148):

Where regulations are promulgated by the Secretary of the Treasury under the *general power* granted by the provisions of section 251 of the Revised Statutes to make general rules and regulations for the collection of the revenues, such are deemed and held regulative or administrative merely and not conditions precedent to the right of exemption from duty.

In the present case, the Virgin Islands statute, 26 USC 3350, contains no provision for its administration by regulation. Therefore the instant regulations (180.98, 180.99 and 181.134) were made under general authority. Consequently, compliance is not a condition precedent to recovery in court.

Further, most of the rum involved herein arrived in the United States and was tax-paid prior to issuance of the regulations on June 16, 1941. Therefore, as to that rum appellee is in effect asserting that the Secretary of the Treasury can deprive a taxpayer of a right granted by statute by failing to prescribe regulations for the statute's administration. As to this, *Hannibal Railroad*

*Company v. Smith*, 9 Wall 95, is pertinent, for it was therein held that failure of the Secretary of the Interior to furnish certain plats of land as required by a statute granting this land could not defeat the grantee's rights to the land.

Also, it is well established that administrative officials cannot alter, amend, or extend a statute. See *Williamson v. US*, 207 US 425, *Re Nellea*, 5 F 2d 687, *Riverdale v. Commission*, 48 F 2d 711, and *Helvering v. Powers*, 293 US 214.

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### CONCLUSION

It is respectfully submitted that the judgment appealed from should be reversed.

San Francisco, June 3, 1946.

FRANK L. LAWRENCE

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*Attorneys for Appellant*

(APPENDIX FOLLOWS)

## Appendix

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TREASURY DEPARTMENT. Office of Internal Revenue.  
Hon. Columbus Delano, Commissioner  
(Official)

Liabilities of Persons who Mix Spirits or  
Liquors of Different Strengths  
or Different Kinds

Office of Internal Revenue  
Washington, Sept. 16, 1869

Sir: Your letter of the 1st instant has been received.

You ask if, when whiskey of different strengths is mixed, and the strength made uniform, such process is considered in the eye of the law as rectification; also, if reduction of liquors by water is looked upon as rectification.

In reply I will call your attention to the provisions of the 1st section of the act of April 10, 1869, defining rectification, and especially the clause in regard to compounding liquors for sale.

To mix distilled spirits, wines or other liquors with any material, does constitute rectification, *if by such mixing a spurious, imitation, or compound liquor is manufactured. To mix any material with distilled spirits, wine or other liquor, which does not result in producing either a spurious, imitation, or compound liquor, is not rectification.* As, for instance, though pure water is a material different from spirits, yet the addition thereof to spirits is held not to constitute rectification, as it does not result in the pro-

duction either of a spurious, imitation or compound liquor, but leaves the particular spirits, the same in kind only lower in proof.

To determine whether the mixing is rectification or not under this clause of the statute, you must, therefore, look to the result, and see whether either of the three kinds of liquors named, is manufactured by the mixing. A spurious liquor is an imitation of, and held out to be genuine. An imitation liquor is one that is in imitation of the genuine, and held out as such imitation. *A compound liquor is any liquor composed of two or more kinds of spirits mixed with any material which changes the original character of either so as to produce a different kind as known to the trade.*

It follows, therefore, that the mixing of liquors identical in kind as known to the trade, does not constitute rectification; but dealers mixing spirits, wines, or other liquors of the same kind, in making change of package, must do so in such a way as to enable them to comply with section 47, of the act of July 20, 1868. As all changes of packages made on premises of a dealer are presumed to be made for the purpose of sale, the requirements of said section apply to all such changes. Therefore a dealer must not mix spirits of different kinds, as that would be rectification; nor of the same kind from different distillers or distilleries, or rectifiers, as by so doing he places it beyond his power to mark and brand the new packages as required by said section 47, and Series 5, No. 7, Supplement No. 1 (10 Record, 82).

What is said above concerning the mixing of distilled spirits, wines, or other liquors, or of any material with such spirits, wines, or other liquors, is applicable only to

that part of section 1 of the act of April 10, 1869, concerning the compounding of liquors for sale. A party may become a rectifier under the previous clause of said section, by any manipulation of spirits, which results in rectifying, purifying, or refining the same by any process, other than by original and continuous distillation from mash, wort, or wash, through continuous closed vessels and pipes until the manufacture thereof is complete. For instance, a party may mix a material with spirits, wine, or other liquor, which will not produce either a spurious, imitation, or compound liquor, but such mixing is nevertheless rectification, if it results in either purifying, or refining the spirits, wine, or other liquors thus mixed.

C. DELANO, Commissioner

R. M. Smith, Esq.,  
Collector, 3d District  
Baltimore, Maryland



No. 11169

IN THE

# United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

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HAROLD E. STETSON,

*Appellant,*

*vs.*

AMERICAN HAWAIIAN STEAMSHIP COM-  
PANY, a Corporation, and THE  
UNITED STATES OF AMERICA,

*Appellees.*

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## APPELLEES' BRIEF.

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FILED

JAN 16 1946

PAUL P. O'BRIEN,  
CLERK





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PANY, a Corporation, and THE  
UNITED STATES OF AMERICA,

*Appellees.*

---

## APPELLEE'S BRIEF.

---

### Statement of the Case.

The United States of America at all times herein mentioned was the owner of the Steamship "Daniel Boone," and the American Hawaiian Steamship Company was acting as general agents for the United States of America in the operation thereof [Ap. 89].

On the 25th day of April, 1942, appellant Harold E. Stetson signed shipping articles at San Pedro, California, as an able-bodied seaman for a foreign voyage on the S.S. "Daniel Boone" not to exceed twelve months [Ap. 36]. That on the 5th day of June, 1942, appellant scratched the back of his finger and, upon the arrival of

the vessel at Melbourne, Australia, was taken to the hospital on June 8, 1942, for treatment [Ap. 56-57]. On June 12, 1942, the master of the vessel instructed the agents at Melbourne to send appellant to Sydney, Australia, to rejoin the vessel if he was physically fit, and on June 13, 1942, the vessel sailed in convoy for Sydney, Australia, arriving there on June 13, 1942. Upon the arrival of the vessel at Sydney her master inquired of the agents there about appellant and was informed that they knew nothing about him. On June 22, 1942, the vessel sailed in convoy for Brisbane, Australia, and, upon arrival there on June 25, 1942, the agents advised the master that the doctor would not allow appellant to rejoin the vessel. The master then left with the agents at Brisbane an account of Stetson's earned wages, giving instructions for the payment thereof [Ap. 113]. Appellant was discharged from the hospital at Melbourne, Australia, on June 25, 1942, and certified fit for duty [Ap. 92]. He was repatriated to the United States and arrived at San Pedro, California, on August 26, 1942. Appellant was paid port bonuses amounting to the sum of \$225.00 upon his return voyage, having signed on board the S.S. "Roamer" as a crew member [Ap. 52]. The S.S. "Daniel Boone" arrived at Baltimore, Maryland, on November 30, 1942, and terminated her voyage on December 2, 1942 [Ap. 111]. Appellant received the sum of \$462.55, which was in full payment for all wages, overtime, bonuses, etc., from April 25, 1942, to June 8, 1942, the date when he left the vessel at Melbourne, Australia [Ap. 32]. In addition thereto he was paid the further sum of \$283.33 in full and complete settlement of any and all claims against the S.S. "Daniel Boone," her owners, agents, etc., and signed a full and complete release therefor on January 9, 1943 [Ap. 45-46].

## ARGUMENT.

### I.

#### Trial De Novo.

**In Appellant's Brief It Is Urged That This Appeal Being in Admiralty Is a Trial De Novo.**

We contend that regardless of a trial de novo, the findings of the District Court should be given great weight.

The apostles on appeal show that all the witnesses testified in open court, and the District Court had the opportunity of seeing and hearing their testimony and continuously propounded questions to the witnesses.

This court in numerous cases has affirmed the well established rule that decisions of the trial court, in admiralty, when based upon testimony heard in open court by the trial judge, will not be disturbed by the Appellate Court.

In the case of *The Ernest H. Meyer* (C. C. A. 9) 84 F. (2d) 496, this court, at page 500, said:

“Until in this or some other case the Supreme Court shall clear up the doubt, we therefore adhere to the rule as stated in *The Andrea F. Luckenbach*, (C. C. A. 9), 78 F. (2d) 827, 828, as follows: ‘The well established rule is applicable that the decision of the trial court in admiralty cases upon controverted questions of fact will not be disturbed by the appellate court unless clearly against the weight of the evidence.’ ”

See also:

*Thomas v. Pacific Steamship Lines*, 84 F. (2d) 506 (C. C. A. 9);

*The Shangho*, 88 F. (2d) 42 (C. C. A. 9);

*The Silver Palm*, 94 F. (2d) 754 (C. C. A. 9).

## II.

**The Findings of Fact and Conclusions of the District Court as to Validity of the Release Executed by Appellant Are Entitled to Great Weight as They Are Based Entirely Upon the Testimony in Open Court, and the Release in the Case at Bar Is Valid and Binding Upon Appellant.**

The release involved is set forth in full on pages 45-46 in the apostles on appeal and for the convenience of this Honorable Court, there is attached to appellee's brief, as supplement thereto, a copy of said release, together with a copy of the Findings of Fact and Conclusions of Law of the District Court which is reported in 1945 A. M. C. 1155.

The testimony of Edward M. Slevin, Claim Agent for the American Hawaiian Steamship Company, General Agents for the United States War Shipping Administration, shows in detail all of the surrounding circumstances leading up to the execution of the release by appellant [Ap. 86-95], and after both appellant and Mr. Slevin had thoroughly discussed all of appellant's claims they figured the amount due to be the sum of \$283.33. As it was getting late in the afternoon of January 8, 1943, appellant did not have time to go to the Shipping Commissioner's office to sign off for the balance due as wages, etc., up to the time he left the vessel at Melbourne, Australia, on June 8, 1942. Therefore Mr. Slevin advanced appellant an additional sum of \$75.00 and appellant agreed to come back the next day and execute a release upon the payment of the balance due after he had signed off the mutual consent before the Shipping Commissioner for the balance due as wages earned while on board the vessel; that appellant returned to the office of Mr. Slevin the next day, and Mr. Slevin handed him the release and asked him to

read it and make sure that he understood it. Appellant read over the release very carefully and said he understood it thoroughly, and he then wrote thereon, in his own handwriting, the following: "I have read and understand this release," and then signed it [Ap. 93-95].

The testimony of appellant shows that he had read the release thoroughly and knew what it contained, and that Mr. Slevin had fully explained it to him and had said that it was a full release of all claims, after which appellant signed the release and the same was witnessed in his presence, and that appellant had written, in his own handwriting, the following: "I have read and understand this release" [Ap. 107-108]. Appellant also testified that he was at the time of the trial a second mate [Ap. 56]. The District Court, after hearing the testimony of appellant and Mr. Slevin relative to the release, made its findings in regard thereto which are fully supported by all the evidence, as follows:

#### "VIII.

"That on January 8, 1943, libelant called at the office of the American Hawaiian Steamship Company in connection with payment of wages, overtime, voyage bonuses and port bonuses, maintenance, transportation and subsistence which he claimed to be due after he had left the steamship 'Daniel Boone,' and he fully discussed his claim with the Claims Agent of the American Hawaiian Steamship Company, at which time libelant was shown a copy of a letter sent to him by the Maritime War Emergency Board in reply to a letter he had sent to the Board relative to the payment of war bonuses, advising libelant that in accordance with the Board decisions he was not entitled to bonuses on the return voyage as he had signed on board another vessel as a crew member on his return to the United States.

“IX.

“That on January 9, 1943, libelant again called at the office of the American Hawaiian Steamship Company at which time his claims were further discussed and a full release was presented to him for his signature after the claims agent had fully explained to him, that if he signed the release he was releasing any and all claims of every nature whatsoever; that libelant is now an officer in the Merchant Marine and from the way he conducted himself in court and from the language he speaks he is a literate person and fully understood the terms of the release. That libelant read the release and wrote thereon, in his own handwriting, the following: ‘I have read and understand this release,’ and then signed the release before a witness and received and acknowledged receipt of \$283.33 in consideration therefor. Libelant testified that he understood the contents of the release before he signed it; that the release was executed freely, without deception or coercion and was made by libelant with the full understanding of his rights and it was a complete release of all liability for the claims set forth in the libel.” [Ap. 121-122.]

We submit, in view of the testimony, that the findings of the District Court as to the validity of the release are entitled to great weight, and the release executed by the appellant is valid and binding on appellant. Appellant in his brief admits that he knew that he was executing a release but attempts to nullify the validity of the release by showing that all the money due appellant was not paid. Furthermore, that at the time the release was executed, only the sum of \$17.18 was paid. We submit that appellant was paid amounts from time to time and that the facts surrounding the execution of the release commenced



with the conversation between Mr. Slevin and appellant on January 8, 1943, was finally concluded on January 9, and that during this conversation an additional advance of \$75.00 was paid to appellant on account. In the case at bar the testimony shows that appellant was discharged from the hospital on June 25, 1942 [Ap. 57] and was certified fit for duty and, upon his arrival at San Pedro, he was well and in good health [Ap. 92].

In the case of *Garrett v. Moore-McCormack Co.*, 317 U. S. 239, 63 S. Ct. 246, 87 L. ed. 239, 1942 A. M. C. 1645, cited on page 6 of appellant's opening brief, the Supreme Court did not attempt to pass on the legality of the seaman's release then before the Court, but remitted the cause "for action not inconsistent with this opinion."

The question was finally decided in the case of *Garrett v. Moore & McCormack Co.*, 1944 A. M. C. 422, when the Court, upholding the validity of a seaman's release, said at page 427:

"It should not be concluded, however, that a release made by a seaman is so immunized by the protective cloak of the Admiralty court as to be wholly without any legal effect. Thus, in *The Adonis* (3 C. C. A. 1930), 1930 A. M. C. 1177, at page 1178, 38 F. (2d) 743, the libellant sought to avoid a release on the ground that he was in pain at the time he made it. The court, rejecting the disavowance, said, 'However pain and need of money may have induced him to sign what otherwise is a valid release, these moving considerations, which emanated within himself, not from the casualty company, do not amount, as he contends, to legal duress and undue influence. \* \* \*

We realize that a release of this kind is not a bar

preventing inquiry into the seaman's rights. It can always be looked into \* \* \*. But a release of this kind, formally signed, sealed and witnessed, is however, *prima facie* good, and cannot be set aside unless it was obtained by duress, mistake, or \* \* \* fraud.' See also *Spillers v. South Atlantic S. S. Co.* (D. C. Del., 1942), 1942 A. M. C. 1063, 45 F. Supp. 2.

"It would, therefore, follow that the burden imposed by the Admiralty law upon those who seek to assert a release as a bar to an action, does not arise *ab initio*, but is postponed until the *prima facie* validity of the release has been denied. In this sense, therefore, one who would avoid the legal effect of a written release has the burden of proving his claim. If *prima facie* the release is valid, as above indicated, the burden which thereafter devolves upon the party relying upon the release, although described as a 'burden of proof,' is in the stricter sense a burden of proceeding forward with the evidence. This result must follow from the requirement imposed upon the claimant seaman that he prove that he was defrauded: *The Annie L. Mulford* (D. C. E. D. Pa. (1901), 107 Fed. 525.

"If, therefore, the weight of the evidence establishes that the release was fairly entered into and without advantage taken of the seaman, his release, like that of any other individual, is to be sustained. The compelling logic behind this rule is articulated in *Sitchon v. American Export Lines, Inc.* (2 C. C. A. 1940), 1940 A. M. C. 1292, at page 1296, 113 F. (2d) 830 (cert. denied 311 U. S. 705, 1940 A. M. C. 1672); 'Any other result would be no kindness to the seaman, for it would make all settlements dangerous from the employer's standpoint and thus tend to force the seaman more regularly into the courts. \* \* \*'"

The validity of seamen's releases has been brought before the courts on many occasions. It has never been contended successfully that when a seaman executes a release with a full understanding of his rights and after a full disclosure of all the facts, as in the case at bar, such a release is not a valid, subsisting and binding contract. One of the leading cases on the validity of releases is the case of *Bonici v. Standard Oil Co. of New Jersey*, 103 F. (2d) 437, 1939 A. M. C. 585, wherein the court, at page 439, said.

"\* \* \* nevertheless a release fairly entered into and fairly safeguarding the rights of the seaman should be sustained. Any other result would be no kindness to the seaman, for it would make all settlements dangerous from the employer's standpoint and thus tend to force the seaman more regularly into the courts of admiralty."

In an opinion delivered by Mr. Justice Story in *Harden v. Gordon*, 11 Fed. Cas. 480, No. 6047, at page 487, he states that:

"When a receipt is given in full of all demands, it is not to be taken in the admiralty as conclusive. It is open to explanation, and upon satisfactory evidence may be restrained in its operation. But the natural presumption is in its favor, and that presumption will prevail, until it is displaced by direct proof or strong circumstances. Indeed in cases of doubtful or conflicting claims, where a compromise takes place, and receipts are given, as final discharges between the

parties, upon deliberate consideration and in good faith, there is the greatest reason to uphold these instruments, for they tend to general repose and security."

A careful reading of the record of the case at bar permits no other view than that appellant thoroughly understood the contents of the instrument which he signed, was well advised of all the facts and circumstances and well knew the consequences of its signing [Ap. 121-122].

Appellant has cited in his opening brief on pages 6, 7 and 8, several cases in which the question of the validity of seamen's releases was before the court.

The cases cited by appellant involved releases which were set aside on the ground of fraud as the seaman did not know the condition of his injuries at the time of the execution of the release and discovered at a later date that the injuries were serious. In each of these cases the court was required to pass on the validity of a release of liability for the seaman's injuries and such releases were set aside on the ground of fraud on a showing that at the time of executing the release the seaman had not been advised of the full extent of his injuries, and therefore, when the seaman's injuries were subsequently discovered to be of a more serious nature than had been supposed at the time of executing the release, the seaman was not precluded by his release from bringing a subsequent suit for the injuries.

Manifestly these cases are not in point. The subject matter involved in the release in question was not beyond

the comprehension of appellant, it did not require the assistance of a competent medical advisor or other especially trained person to advise him. The slight scratch which appellant had previously suffered had completely healed and appellant does not contend that the facts are otherwise than as he fully understood them to be at the time he executed the release.

Furthermore, the District Court found that appellant:

“\* \* \* is now an officer in the Merchant Marine and from the way he conducted himself in court and from the language he speaks he is a literate person and fully understands the terms of the release. That libelant read the release and wrote thereon, in his own handwriting, the following: ‘I have read and understand this release,’ and then signed the release before a witness and received and acknowledged receipt of \$283.33 in consideration therefor. Libelant testified that he understood the contents of the release before he signed it; that the release was executed freely, without deception or coercion and was made by libelant with the full understanding of his rights and it was a complete release of all liability for the claims set forth in the libel.” [Ap. 122.]

It is submitted that the above findings of fact of the District Court are well supported by the evidence and the Court having had an opportunity to observe the demeanor of all the witnesses the findings of the District Court are entitled to great weight.

III.

**Appellant Is Not Entitled to the Wages and Overtime He Would Have Earned on the Vessel After He Had Fully Recovered From His Injuries and Was Repatriated Back to the United States.**

It is contended in appellant's brief, at pages 9-10, that although appellant was physically able to return to his employment upon his return to the United States, he was prevented from doing so by reason of the failure of the respondent to leave his wages and gear at the port where he was hospitalized and by the failure to pay him the full amount due him upon his return to the United States [Ap. 9-10]. We submit that the testimony of Mr. Slevin shows that appellant desired to take a vacation after his return to the United States [Ap. 101-102]. The fact that he went to work at a date prior to the termination of the voyage of the S.S. "Daniel Boone" on December 2, 1942, and before he received his wages and gear, shows that he could have returned to work at any time he so desired. On pages 10-11 of appellant's brief, it is admitted that this question is unanswered by the cases but that by way of analogy to this situation where a seaman was *wrongfully dismissed before the end of the voyage* his wages are due for the whole voyage or until the period for which he was engaged terminated, if he has not before that time found new and equally lucrative employment.

The facts in the case at bar show that appellant was not wrongfully dismissed but left the vessel and was taken to a hospital on account of a slight injury to his finger [Ap. 56-57].

That appellant is not entitled to overtime for any period that he was not on board the S.S. "Daniel Boone" seems too clear for argument. Overtime is paid to seamen for

work done in addition to their regular duties, for extra work performed. As said in the case of *President Grant-President Jefferson*, 1927 A. M. C. 51, a seaman claiming overtime must plead the regular hours worked and the overtime with particularity as to days and hours, and must show whether the vessel was at sea or in port.

Overtime is extra wages for extra work, payable only in accordance with an agreement entered into between the employer on the one hand and the union representatives of the seaman on the other. A seaman does not become entitled to overtime by signing the articles, nor does any one seaman have any interest or claim to the overtime earned by another. Overtime is paid to each seaman, at an hourly rate, according to the extra number of hours each seaman works outside or in addition to his regular working day.

The shipping articles signed by appellant contain the entire contract between appellant and the master of the S.S. "Daniel Boone." Nowhere in this contract will there be found any right in appellant to overtime arising out of his employment as a seaman of the S.S. "Daniel Boone" [Ap. 75-77].

None of the cases cited by appellant supports any claim for overtime. In *The Walton v. The Neptune*, Fed. Cas. No. 17, 135, the Court was only concerned with the seaman's monthly wage as evidenced by the shipping articles; in the case of *Mason v. Evanisevich* (C. C. A. 9), 131 F. (2d) 858, 1942 A. M. C. 1542, the Court was called upon to determine the share that an injured fisherman was entitled to out of the season's catch; in *Scerio v. Ivan*, 1944 A. M. C. 409, an award for loss of earning capacity was made in lieu of an award for loss of wages, and the seaman's base wages were used as the measure thereof; in

*The Strom v. Montague*, 53 F. Supp. 548, 1944 A. M. C. 122, the Court was concerned with the question of what share an injured fisherman was entitled to out of the season's catch; and in *The Cekalovich v. Ruljanovich* (C. C. A. 9), 1944 A. M. C. 1468, the Court was again required to decide what share an injured fisherman was entitled to out of the season's catch.

#### IV.

#### **Bonus Payments Are Not Wages, and a Seaman Who Has Been Detached From His Ship for Any Reason Is Not Entitled to Any Bonuses After the Date Such Seaman Became Detached.**

Soon after the outbreak of war against the Axis nations the Maritime War Emergency Board was established by the shipowners and the maritime unions signatory to the Statement of Principles. In recognition of the risk undertaken by seamen in the pursuit of their employment, the Maritime War Emergency Board established various war bonuses commensurate with the risk to seamen in the various theaters of the world. The various war bonuses established from time to time was neither static nor uniform. The theory underlying this system of bonuses was that the bonuses would be decreased and increased as the risk to the seamen should vary.

As such war bonuses were not a wage subsidy but rather compensation for the hazard undertaken by the seamen. it was never contemplated that seaman who had not incurred the risk by entering a given war theater should receive the bonus offered by the United States Government as an inducement to seamen to accept the risks of war.



The shipping articles in the case at bar provide, among other things, that:

“All licensed and unlicensed members of the crew will be paid a War Bonus in accordance with the United States Maritime War Emergency Board Decisions.” [Ap. 75.]

The Maritime War Emergency Board advised appellant that he was not entitled to wages and bonuses from the S.S. “Daniel Boone” on his return trip on another vessel as a result of any Board decision [Ap. 43]. The Pacific Coast Regional Counsel for the War Shipping Administration, in its opinion relative to the payment of war bonuses to appellant, said:

“War bonuses are only payable in accordance with the decisions of that Board. A seaman never has been entitled to any bonuses earned by a vessel after his separation from that vessel.” [Ap. 49.]

In connection with the payment of bonuses to appellant, the District Court made its findings as follows:

“VI.

“That the Shipping Articles signed by libelant for the voyage on board the Steamship ‘Daniel Boone’ provided for the payment of his wages at the rate of \$100.00 per month and War Bonuses in accordance with the United States Maritime War Emergency Board Decisions; that when a seaman enters into an agreement that bonuses shall only be paid in accordance with the United States Maritime War Emergency Board Decisions he realizes that bonuses are not a matter of right except insofar as they are regulated by these decisions, which may change from time to time; that bonuses are inducements earned at various times under the direction of the Maritime

War Emergency Board Decisions in order to compensate for the greater or lesser hazards to seamen; that libelant, in signing the Articles, agreed that the decisions of the Maritime War Emergency Board shall be the criterion as to whether or not he is entitled to receive bonuses; that it is quite evident, in the established system of bonuses, the Maritime War Emergency Board sought to supply an additional incentive for the taking of the risk; that the Board did not enter into an agreement to the effect that no matter what happened to the particular seaman whether he actually continued on the ship or separated himself from the ship that he was entitled to all the emoluments and all the compensation he might have received had he stayed with the ship." [Ap. 120.]

Appellant has cited several cases in an attempt to support his claim for the payment of the same bonuses as earned by members of the crew aboard the S.S. "Daniel Boone" after he left the vessel (Appellant's Brief pp. 12-13).

The case of *The Leonidas*, 116 F. (2d) 440, 1941 A. M. C. 190, cited by appellant, is not in point since it involves bonuses that were actually earned by the seaman while on board. The question before the Court was not what bonuses the seaman was entitled to, but rather it was a question of collection of bonuses admittedly due. The specific question before the Court was whether or not the seaman was entitled to collect one-half of earned wages under 46 U. S. C. A. Section 597.

This case is further distinguishable from the case at bar since it involved a Greek war bonus rather than an American war bonus.

The case of *The Eleni* (C. C. A. 2), 140 F. (2d) 111, 1942 A. M. C. 1545, cited by appellant, again is distinguishable from the case at bar since it involved a claim not for bonuses earned by the ship after the seaman became detached but rather for bonuses earned by the seaman while on board ship. It also involves a claim for bonuses payable by the Greek Government in Exile. Notwithstanding, however, that this case is distinguishable, the language of the Court would not lend support to appellant's position. The Court, at page 1549, said, after discussing the incidents of the Greek war bonus, "The bonus under such a contract is not a wage."

In the case of *Dasher v. U. S.*, 59 F. Supp. 742, 1945 A. M. C. 100, cited by appellant, it was held that a seaman injured without fault while ashore at a Mediterranean port and off duty is entitled to wages and *applicable war bonus* while in the hospital ashore. It should be noted that this case is distinguishable on two grounds:

(a) The seaman was never discharged from the ship's articles but continued throughout his confinement as a member of the crew, and

(b) The seaman remained in the bonus area and thus was entitled to bonuses from that fact alone rather than from the fact of the ship's entry into a bonus area after the seaman's detachment as in the case at bar.

The case of *Gayner v. The New Orleans*, 54 F. Supp. 25, 1944 A. M. C. 462, cited by appellant, was not a case involving war bonuses. This case involved an agreement entered into between certain collective bargaining representatives and certain ferry boat companies in the San Francisco Bay area. In anticipation of the eventual loss of employment due to the construction of the San Fran-

cisco and Golden Gate bridges this agreement was entered into providing for extra compensation for the employees of the ferry boat companies who should eventually lose their employment. Having satisfied the terms of the agreement, the only issue before the Court was whether a maritime lien arose in favor of these employees for the so-called extra compensation. The Court, in upholding the maritime lien, pointed out that the ferry boat employees had parted with a substantial *quid pro quo*. The case is clearly not in support of appellant's contention for the payment of bonuses.

In the case of *Phillips v. Matson Navigation Co.*, 1945 A. M. C. 940, cited by appellant, the United States District Court, Northern District of California, on August 23, 1945, modified its opinion on reargument (1945 A. M. C. 1153), and in holding that a seaman is not entitled to "war bonuses" while on land, at pages 1153-1154, said:

"The amount of 'war bonus' to be paid to seamen and the terms conditioning its payment are fixed by the 'Maritime War Emergency Board' (whose members are appointed by the President), created pursuant to agreement between ship operators and the maritime unions. The Shipping Articles governing libellant's employment were signed by him on June 20, 1944. They expressly incorporate therein all decisions of the 'Maritime War Emergency Board.' On June 20, 1944, and at the time of libellant's shore hospitalization, there was in effect decision 2B of the Board to the effect that: 'bonus shall not be payable while a crew member is on land.' *Thus under the express terms of the contract between the parties litigant, libellant is not entitled to war bonus and accordingly the claim therefor is disallowed.*" (Italics ours.)

Therefore, it appears that appellant would have no claim for bonuses after he left the vessel at Melbourne, Australia, as he was not aboard the vessel while she was within any bonus area.

### Conclusion.

We respectfully submit that appellant has been paid in full for any and all claims that he had against appellees by reason of the voyage involved but, in any event, the release executed by appellant was a full and complete release of any and all claims set forth in the libel as it was executed by him freely, without deception or coercion and with the full and complete understanding of all of his rights in the matter, and therefore the final decree of the District Court should be affirmed.

Respectfully submitted,

L. K. VERMILLE,

DAN BRENNAN,

OVERTON, LYMAN, PLUMB,

PRINCE & VERMILLE,

*Proctors for Appellee American Hawaiian Steamship  
Company.*

CHARLES H. CARR,

*United States Attorney.*

RONALD WALKER,

*Assistant United States Attorney,*

*Proctors for Appellee, United States of America.*









## SUPPLEMENT.

### RECEIPT AND RELEASE.

Know All Men by These Presents: That the undersigned, Harold Stetson, in consideration of the payment to him of the sum of Two Hundred Eighty-three & 33/100 Dollars (283.33) lawful money of the United States of America, the receipt whereof is hereby acknowledged, does hereby release and forever discharge American-Hawaiian Steamship Company, a corporation, the Steamship "Daniel Boone," its Master, officers, agents, crew, and each of them, the War Shipping Administration, United States of America, and Fireman's Fund Insurance Company, from any and all claims and demands of every nature whatsoever by the undersigned from the beginning of the world to and including the present time, and without limiting this release to any specific claim or claims, whether mentioned herein or not, the undersigned does hereby release said vessel and said parties and each of them from all claims arising out of or in connection with that certain injury and/or illness suffered by the undersigned while employed by said vessel on or about June 5, 1942, including, without limitation however, all claims for damages at law and in admiralty, including interest and costs, and for wages, maintenance, cure, transportation, and subsistence, under any act or law, it being the intention of this instrument to acknowledge full and complete settlement and satisfaction for any loss, damage, injury, sickness, or expense, suffered or sustained or claimed by the undersigned, as aforesaid, whether the

same be now existent or known to him, or which may hereafter arise, develop or be discovered.

Dated at San Francisco this 9 day of Jan 1943.

THIS IS A GENERAL RELEASE

I have read and understand this release.

HAROLD STETSON.

E. M. SLEVIN,  
Witness.

[TITLE OF COURT AND CAUSE.]

## FINDINGS OF FACT AND CONCLUSIONS OF LAW.

The above entitled action came on regularly for trial on the 24th day of May, 1945, before Hon. Leon R. Yankwich, United States District Judge, the libelant being represented by David A. Fall, Esq.; respondent American Hawaiian Steamship Company being represented by Messrs. Overton, Lyman & Plumb and L. K. Vermille, Esq.; and respondent United States of America being represented by Charles H. Carr, Esq., United States Attorney, and Ronald Walker, Esq., Assistant United States Attorney; and evidence, oral and documentary, having been introduced, and the Court having considered the evidence and the law and the arguments of counsel, and being fully advised in the premises, and all proceedings having been duly and regularly taken, the Court makes the following findings of fact and conclusions of law:

### FINDINGS OF FACT

#### I.

That libelant was an able bodied seaman on board the steamship "Daniel Boone," having signed thereon or about the 25th day of April, 1942, for a voyage not to exceed twelve months bound for foreign ports unnamed.

#### II.

That the United States of America was the owner of the steamship "Daniel Boone," and the American Hawaiian Steamship Company was acting as general agent for the War Shipping Administration in the operation thereof.

#### III.

That libelant on or about the 5th day of June, 1942, while in the service of said steamship "Daniel Boone," sus-

tained injuries of a minor nature and was taken to a hospital at Melbourne, Australia, on or about the 8th day of June, 1942.

IV.

That after the steamship "Daniel Boone" left libelant at Melbourne, Australia, on or about the 8th day of June, 1942, it made two bonus port calls at the Port of Townsville, Australia, and one bonus port call at the Port of Moresby, for which each able bodied seaman on board the steamship "Daniel Boone" was paid the sum of \$125.00 for each of said bonus ports, making a total of \$375.00.

V.

That libelant did not rejoin the steamship "Daniel Boone" for the completion of her voyage but was repatriated to the United States of America on board another vessel, having signed thereon as a crew member, and received payment for all bonus ports while on board said vessel; that when libelant arrived in the United States he had completely recovered from his injuries; that the steamship "Daniel Boone" terminated her voyage at Baltimore, Maryland, on or about the 2nd day of December, 1942.

VI.

That the Shipping Articles signed by libelant for the voyage on board the steamship "Daniel Boone" provided for the payment of his wages at the rate of \$100.00 per month and war bonuses in accordance with the United States Maritime War Emergency Board Decisions; that when a seaman enters into an agreement that bonuses shall only be paid in accordance with the United States Maritime War Emergency Board Decisions he realizes that bonuses are not a matter of right except insofar as they are regu-

lated by these decisions, which may change from time to time; that bonuses are inducements earned at various times under the direction of the Maritime War Emergency Board Decisions in order to compensate for the greater or lesser hazards to seamen; that libelant, in signing the Articles, agreed that the decisions of the Maritime War Emergency Board shall be the criterion as to whether or not he is entitled to receive bonuses; that it is quite evident, in the established system of bonuses, the Maritime War Emergency Board sought to supply an additional incentive for the taking of the risk; that the Board did not enter into an agreement to the effect that no matter what happened to the particular seaman whether he actually continued on the ship or separated himself from the ship that he was entitled to all the emoluments and all the compensation he might have received had he stayed with the ship.

#### VII.

That libelant was paid the sum of \$462.55 for his full wages, voyage bonuses, overtime and port bonuses while on board the steamship "Daniel Boone" and in addition thereto the further sum of \$283.33 for a full and complete release of any and all claims and demands for additional wages, voyage bonuses, overtime, port bonuses, maintenance, cure, transportation and subsistence.

#### VIII.

That on January 8, 1943, libelant called at the office of the American Hawaiian Steamship Company in connection with payment of wages, overtime, voyage bonuses and port bonuses, maintenance, transportation and subsistence which he claimed to be due after he had left the steamship "Daniel Boone," and he fully discussed his claim with the Claims Agent of the American Hawaiian Steamship Company, at

which time libelant was shown a copy of a letter sent to him by the Maritime War Emergency Board in reply to a letter he had sent to the Board relative to the payment of war bonuses, advising libelant that in accordance with the Board decisions he was not entitled to bonuses on the return voyage as he had signed on board another vessel as a crew member on his return to the United States.

### IX.

That on January 9, 1943, libelant again called at the office of the American Hawaiian Steamship Company at which time his claims were further discussed and a full release was presented to him for his signature after the claims agent had fully explained to him, that if he signed the release he was releasing any and all claims of every nature whatsoever; that libelant is now an officer in the Merchant Marine and from the way he conducted himself in court and from the language he speaks he is a literate person and fully understood the terms of the release. That libelant read the release and wrote thereon, in his own handwriting, the following: " have read and understand this release," and then signed the release before a witness and received and acknowledged receipt of \$283.33 in consideration therefor. Libelant testified that he understood the contents of the release before he signed it; that the release was executed freely, without deception or coercion and was made by libelant with the full understanding of his rights and it was a complete release of all liability for the claims set forth in the libel.

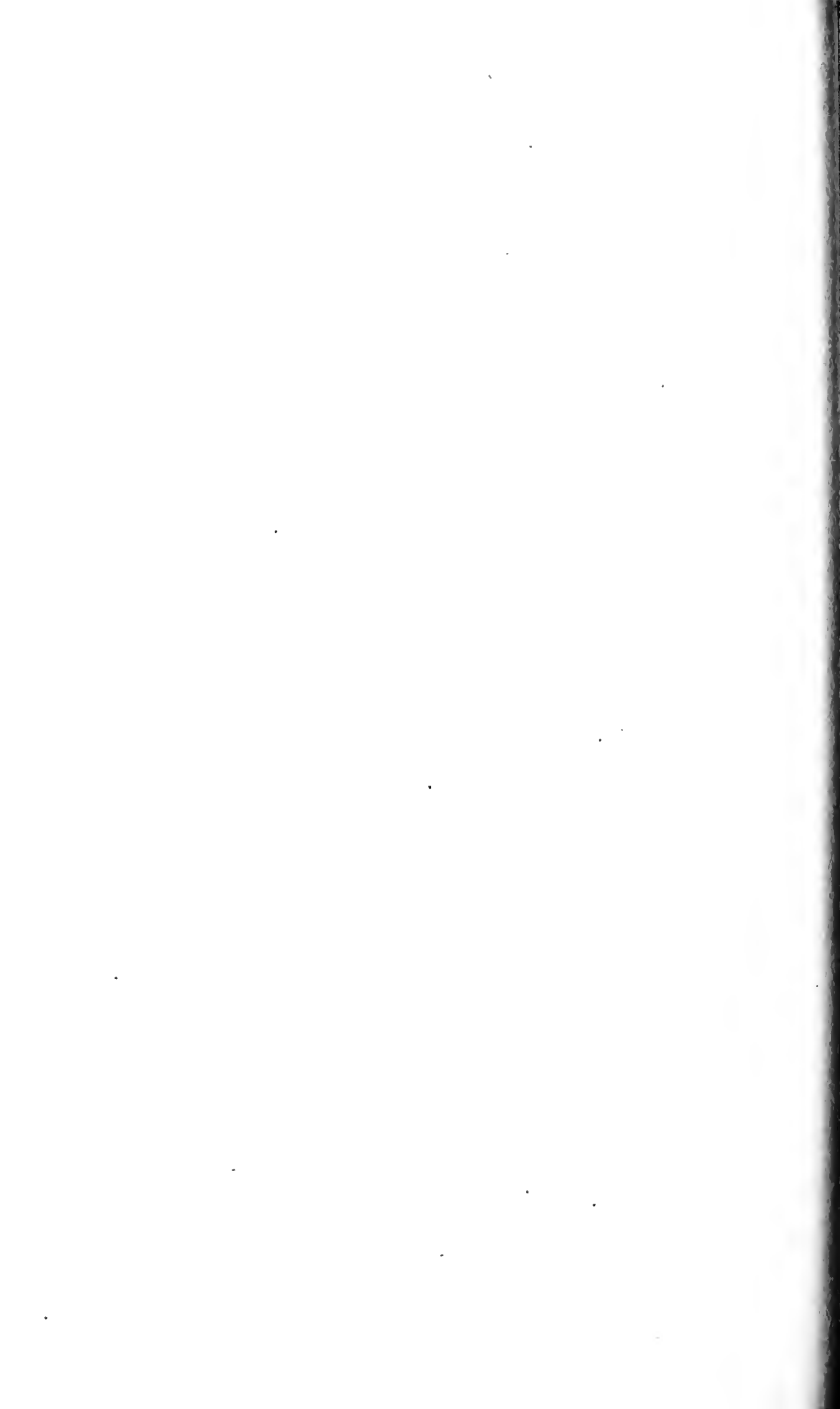
CONCLUSIONS OF LAW.

The Court makes the following conclusions of law on the findings of fact:

That the libelant Harold E. Stetson is not entitled to recover any sum whatsoever from the respondent American Hawaiian Steamship Company, a corporation, and The United States of America, or either of them, and that said libel should be dismissed without costs to said respondents.

LEON R. YANKWICH,  
*United States District Judge.*

*signed as to form*  
DAVID A. FALL,  
*Proctor for Libelant.*





No. 11171

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**United States**  
**Circuit Court of Appeals**

*For the Ninth Circuit.*

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KENTON GEORGE SCHULTZ,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

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**Transcript of Record**

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Upon Appeal from the District Court of the United States  
for the Southern District of California,  
Central Division

FILED

FEB 14 1946

PAUL P. O'BRIEN,  
CLERK



No. 11171

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United States  
Circuit Court of Appeals

For the Ninth Circuit.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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Los Angeles 12, Calif. [1\*]

In the District Court of the United States in and for  
the Southern District of California, Northern  
Division

No. 2624

April, 1945, Term

THE UNITED STATES OF AMERICA,

vs.

KENTON GEORGE SCHULTZ,

Viol.: United States Code, Title 50, Appendix, Sec-  
tion 311 Selective Training and Service Act  
of 1940

### INDICTMENT

In the Name and by the Authority of the United States of America, the Grand Jury for the Southern District of California, at Los Angeles, presents on oath in open court:

That Kenton George Schultz, hereinafter called the defendant, is a male person within the class made subject to selective service under the Selective Training and Service Act of 1940, as amended; that defendant registered as required by said Act and the rules and regulations promulgated thereunder and became a registrant of Local Board No. 129, said board being then and there duly created and acting, under the Selective Service System established by said Act, in the County of Kings, State of California, in the division and district aforesaid; that pursuant to the terms and provisions of said Act and the rules and regulations promulgated thereunder, said defendant was classified in Class I-A and was subsequently notified of said classification by said board, and a



notice and order by said board was thereafter duly given to said defendant to report for induction into the armed forces of the United States of America on December 27, 1943, at Hanford, Kings County, California, within the division and district aforesaid; that said defendant did at said time and place knowingly and unlawfully fail and neglect to perform a duty required of him under said Act and the rules and regulations promulgated thereunder, that is to say, the defendant did then and there knowingly and unlawfully fail and neglect to report for induction into the armed forces of the United States, as so notified and ordered to do;

Contrary to the form of the statute in such case made and provided and against the peace and dignity of the United States of America. [2]

## COUNT TWO

And the Grand Jury aforesaid, upon its oath aforesaid, does further present:

That Kenton George Schultz, hereinafter called the defendant, is a male person within the class made subject to selective service under the Selective Training and Service Act of 1940; that defendant registered on October 16, 1940, as required by said act and the rules and regulations promulgated thereunder, and thereupon became a registrant of Local Board No. 129, said board being then and there duly created and acting under the Selective Service System, established by said act, in the County of Kings, State of California, within the division and district aforesaid; that from on or about September 16, 1943, and at all times thereafter, at Hanford, Kings

County, California, within the division and district aforesaid; the said defendant did knowingly fail and neglect to perform a duty required of him under said act and the rules and regulations promulgated thereunder, in that he did then and there knowingly fail and neglect to keep said Local Board No. 129 advised of the address where mail would reach him;

Contrary to the form of the statute in such case made and provided and against the peace and dignity of the United States of America.

(Signed) CHARLES H. CARR

United States Attorney

[Endorsed]: Filed July 11, 1945. [3]

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[Title of District Court and Cause.]

### MOTION IN ARREST OF JUDGMENT

Comes now Kenton George Schultz, the defendant in the above entitled cause and now moves that the verdict of guilty returned against him by a jury in this Court upon the 10th day of October A. D. 1945, be arrested and no judgment and sentence be imposed thereon for the following reasons:

1. That the indictment upon which the defendant was tried and convicted does not state facts sufficient to constitute a crime against the United States.

2. That the First Count of the indictment to which the defendant entered his plea of not guilty

and which was thereafter, over the objection and exception of the defendant, dismissed [6] by the Court prior to the commencement of the trial, does not state facts sufficient to constitute a crime against the United States.

3. That the Second Count of the indictment upon which the defendant was actually tried and convicted does not state facts therein sufficient to constitute a crime against the United States.

4. That the Second Count of the indictment upon which the defendant was actually tried and convicted states facts which might possibly be sufficient to constitute a misdemeanor if it constitutes any crime at all against the United States, whereas the Statute requires that all violations thereof be pleaded as felonies and they are felonies if any crimes at all.

5. That the Second Count of the indictment in which the defendant was accused and was tried and convicted, fails to state facts sufficient to constitute a felony crime against the United States.

Dated this 12th day of October, 1945.

PEARCE, CAMPBELL, BRYAN  
& NORCOP,

By MAURICE NORCOP

Attorneys for Defendant.

## AUTHORITIES IN SUPPORT OF MOTION

“The general rule is that the term ‘wilfully’ cannot be omitted from an indictment when the term is part of a statutory definition.”

Wharton’s Criminal Procedure (10th Ed.)  
Vol. 1. Secs. 285 and 318.

Rumley v. United States 293 Fed. 532 at  
p 547. [7]

\* \* \* “The indictments charged in part that these defendants well knowing the premises aforesaid, unlawfully did ‘knowingly’ act. This amounts to an allegation of unlawful intent.”

United States v. Altman 8 Fed. Supp. 880  
at 884.

\* \* \* “and it is also generally held that words which import an exercise of the will, such as ‘feloniously’ and ‘unlawfully’ will supply the place of the word ‘wilfully’.”

Howenstine vs. United States 263 Fed. 1 at  
p. 4.

\* \* \* “Where the facts alleged necessarily import wilfulness, the failure to use the word is not fatal to the indictment.” (Underscoring ours)

Van Gesner v. United States 153 Fed. 46.

Additional authorities will be marshalled to support the motion and will be supplied as speedily as they can be collated but counsel warns that if additional authorities are discovered after the expira-

tion of the "five days before October 22nd, 1945, they will, nevertheless, be brought to the Court's attention as speedily as possible. There may well be other elements found to be missing from the indictment which are requisite and fundamental elementary allegations requisite to plead a felony upon which the defendant stands convicted.

Counsel is now continuing the diligent pursuit of a number of inquiries and his research will require several days, but he will, of course, not cite nor produce additional authorities unless he be convinced in his own mind that such authorities will enable the Court to more thoroughly analyze and thereby correctly rule upon the validity of this indictment [8] which attempted to plead a felony under the statute herein involved.

Respectfully submitted,

PEARCE, CAMPBELL, BRYAN  
& NORCOP

By MAURICE NORCOP

Attorney for Defendant.

[Endorsed]: Filed Oct. 13, 1945. [9]

At a stated term, to-wit: The October Term, A.D. 1945, of the District Court of the United States of America, within and for the Northern Division of the Southern District of California, held at the Court Room thereof, in the City of Fresno on Tuesday the 23rd day of October in the year of our Lord one thousand nine hundred and forty-five.

Present: The Honorable Campbell E. Beaumont,  
District Judge

[Title of Cause.]

This cause coming on for (1) further hearing on motion in arrest of judgment and (2) hearing report of the Probation Officer and for sentence of defendant Kenton George Schultz; Mildred L. Kluckhohn, Assistant U. S. Attorney, appearing as counsel for the Government; Maurice Norcop, Esq., appearing as counsel for the said defendant, who is present in custody;

Counsel argue further re (1) motion in arrest of judgment and it is ordered that the said motion is denied and exception allowed.

Attorney Norcop states there is no legal cause why sentence should not be pronounced at this time and argues on defendant's behalf. The Court pronounces judgment as follows: [10]

District Court of the United States, Southern  
District of California, Northern Division

No. 2624

Criminal Indictment in two counts for violation of  
U.S.C., Title 50 (Appendix) secs. 311.

UNITED STATES

v.

KENTON GEORGE SCHULTZ

### JUDGMENT AND COMMITMENT

On this 23rd day of October, 1945, came the United States Attorney, and the defendant Kenton George Schultz, by Maurice Norcop, Esq., his attorney, appearing in proper person, and

The defendant having been convicted on jury's verdict of guilty on Count 2 and the offenses charged and, in the indictment in the above-entitled cause, to wit: failure to keep local draft board advised of the address where mail would reach him, and the defendant having been now asked whether he has anything to say why judgment should not be pronounced against him, and no sufficient cause to the contrary being shown or appearing to the Court, It Is by the Court

Ordered and Adjudged that the defendant, having been found guilty of said offense, is hereby committed to the custody of the Attorney General or his authorized representative for imprisonment for the period of eighteen (18) months.

It Is Further Ordered that the Clerk deliver a certified copy of this judgment and commitment to the United States Marshal or other qualified officer and that the same shall serve as the commitment herein.

(Signed) C. E. BEAUMONT,  
United States District Judge.

The Court recommends commitment to the federal road camp at Tucson, Ariz.

[Endorsed]: Filed Oct. 23, 1945. [11]

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[Title of District Court and Cause.]

NOTICE OF APPEAL TO THE CIRCUIT  
COURT OF APPEALS

Name and Address of Appellant: Kenton George Schultz, County Jail, Fresno, California.

Name and Address of Appellant's Attorneys: Pearce, Campbell, Bryan & Norcop, By Maurice Norcop, Esq., 1010 Pershing Square Building, 448 South Hill Street, Los Angeles, California.

Offense: Knowing failure to keep Local Draft Board advised of Address where communication would reach him. [12]

Date of Judgment: October 23, 1945;

Brief Description of Judgment or Sentence: Sentence of imprisonment for a term of eighteen (18) months in an institution to be designated by the Attorney General of the United States with



the recommendation that the sentence be executed by placement in the Federal Road Camp at Tucson, Arizona.

Name of Prison Where Now Confined: County Jail, Fresno, California.

I, Kenton George Schultz, the above named Appellant, hereby appeal to the United States Circuit Court of Appeals for the Ninth (9th) Circuit from the judgment above-mentioned on the grounds set forth below.

(Signed) KENTON GEORGE SCHULTZ  
(Appellant)

Dated: October 25th, 1945.

#### GROUND'S ON APPEAL

That the Second (2nd) Count of the Indictment upon which I was actually tried and convicted does not state facts therein sufficient to constitute a felony or any crime against the United States.

Respectfully filed and submitted:

(Signed) MAURICE NORCOP

Dated: October 25th, 1945.

[Endorsed]: Filed Oct. 26, 1945.

[Title of District Court and Cause.]

## ASSIGNMENT OF ERRORS

### I.

The Motion in Arrest of Judgment should have been granted and allowed. The second count of the Indictment on which the defendant was tried and convicted fails to state an offense.

### II.

The District Court erred in its opinion, decision and determination in denying the Motion in Arrest of Judgment.

Dated January 10, 1946.

Respectfully submitted,

MAURICE NORCOP

Attorney for Defendant.

[Endorsed]: Filed Jan. 11, 1946.

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[Title of District Court and Cause.]

## CERTIFICATE OF CLERK

I, Edmund L. Smith, Clerk of the District Court of the United States for the Southern District of California, do hereby certify that the foregoing pages numbered from 1 to 18 inclusive contain full, true and correct copies of Indictment; Portions of Minute Orders entered October 9th, 1945 and October 10th, 1945 respectively; Motion in Arrest of Judgment; Minute Order Entered October 23, 1945; Judgment and Commitment Notices of Appeal; Motion for Order Extending Time to File Bill of Ex-

ceptions and Assignment of Errors and Order Granting Same and Order Approving Transcript of Record without Bill of Exceptions which, together with Original Assignment of Errors, transmitted herewith constitute the record on appeal to the United Circuit Court of Appeals for the Ninth Circuit.

I further certify that my fees for preparing, comparing, correcting and certifying the foregoing record amount to \$5.95 which sum has been paid to me by Appellant.

Witness my hand and the seal of said District Court this 16 day of January, 1946.

(Seal) EDMUND L. SMITH

Clerk

By THEODORE HOCKE

Chief Deputy Clerk

---

[Endorsed]: No. 11171. United States Circuit Court of Appeals for the Ninth Circuit. Kenton George Schultz, Appellant, vs. United States of America, Appellee. Transcript of Record. Upon Appeal from the District Court of the United States for the Southern District of California Central Division.

Filed January 19, 1946.

PAUL P. O'BRIEN

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

In the United States Circuit Court of Appeals  
for the Ninth Circuit

No. 11171

KENTON GEORGE SCHULTZ,

Defendant and Appellant,

vs.

UNITED STATES OF AMERICA,

Plaintiff and Appellee.

STATEMENT OF MATTERS UPON WHICH  
APPELLANT INTENDS TO RELY AND  
STIPULATION AS TO RECORD.

Comes now the above named appellant, Kenton George Schultz, and states that he will rely upon all motions and points of law as set forth in the same, and on the assignment of errors, and hereby adopts as his respective points to be relied upon in this appeal all those set forth in the assignment of errors heretofore prepared and filed by him.

Dated January 10, 1946.

MAURICE NORCOP

Attorney for Appellant.

[Endorsed]: Filed January 10, 1946. Paul P. O'Brien, Clerk.

[Title of Circuit Court of Appeals and Cause.]

STIPULATION

It Is Hereby Stipulated and Agreed by and between the Government of the United States, through United States Attorney Charles H. Carr, by Mildred Kluckhohn, Assistant United States Attorney, and Kenton George Schultz through his attorney, Maurice Norcop, that foregoing record will be the complete record necessary for the consideration of the appeal for both sides.

Dated January 10, 1946.

MILDRED L. KLUCKHOHN

Attorney for Appellee.

MAURICE NORCOP

Attorney for Appellant

Received copy of the within this 10 day of January, 1946.

CHARLES H. CARR,

United States Atty.

By MILDRED L. KLUCKHOHN

[Endorsed]: Filed January 10, 1946. Paul P. O'Brien, Clerk.

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[Title of Circuit Court of Appeals and Cause.]

STATEMENT OF POINTS TO BE RELIED  
ON, AND DESIGNATION OF THE RECORD

Comes now the above named Appellant, Kenton George Schultz, and hereby requests the Clerk of

the above entitled Court to have included in the transcript of the record of the following papers:

1. The Indictment;
2. Motion in Arrest of Judgment;
3. Minutes of the Court Relating to the Hearing on the Motion in Arrest of Judgment together with the Ruling of the Court in Denying the Motion;
4. Judgment and Sentence;
5. Notice of Appeal;
6. Assignment of Errors
7. This Statement of Points to be Relied on, and Designation of the Record and Stipulation.

The above named Appellant further states that it is his intention to rely on each and every Point set forth in all the Assignment of Errors.

Dated January 10, 1946.

MAURICE NORCOP

Attorney for Appellant.

Received copy of the within this 10th day of January, 1946.

CHARLES H. CARR

United States Attorney

By MILDRED L. KLUCKHOHN

[Endorsed]: Filed January 19, 1946, Paul P. O'Brien, Clerk.

No. 11171

IN THE

# United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

---

KENTON GEORGE SCHULTZ,

*Appellant,*

*vs.*

UNITED STATES OF AMERICA,

*Appellee.*

---

## APPELLANT'S OPENING BRIEF.

Under Appeal from the District Court of the United States for the  
Southern District of California, Northern Division.

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MAURICE NORCOP,

1000 Pershing Square Building, Los Angeles 13,

*Attorney for Appellant.*

FILED





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No. 11171

IN THE

# United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

---

KENTON GEORGE SCHULTZ,

*Appellant,*

*vs.*

UNITED STATES OF AMERICA,

*Appellee.*

---

## APPELLANT'S OPENING BRIEF.

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### Statement of Facts.

The defendant was indicted on July 11, 1945 [R. 4], by the Grand Jury for the Southern District of California at Los Angeles. The indictment contained two counts [R. 2, 3, 4]. Therein the defendant was accused in each count of having violated the Selective Training and Service Act of 1940 (U. S. C. A. Title 50, Appendix, Section 311). He was arraigned in the Northern Division at Fresno, California, and entered his plea of not guilty to each of the two counts. In October, 1945, the case came on for trial at Fresno. Prior to the commencement of the trial, the District Court, upon the motion of the United States Attorney, dismissed the first count of the indictment over the protest and objection of the defendant [R. 4, 5]. An exception was allowed to the ruling of the Court granting

the dismissal of the first count [R. 5]. He was then tried to a jury on the second count. The defendant was convicted on the 10th day of October, 1945. A motion in Arrest of Judgment was filed [R. 4, 5]. It was argued on the 22nd and 23rd days of October, 1945. The motion was denied on October 23, 1945 [R. 8] and the Court thereupon sentenced the defendant to a prison term of eighteen (18) months [R. 9].

The first count of the indictment accuses the defendant in substance as follows:

“ . . . that said defendant did at said time and place *knowingly and unlawfully* fail and neglect to perform a duty . . . that is to say, the defendant did then and there *knowingly and unlawfully* fail and neglect to report for induction into the armed forces of the United States, as so notified and ordered to do. . . .” (Emphasis supplied.)

Count Two (2) accuses the defendant as follows:

“ . . . the said defendant did *knowingly* fail and neglect to perform a duty required of him under said Act and the rules and regulations promulgated thereunder, in that he did then and there *knowingly* fail and neglect to keep said Local Board No. 129 advised of the address where mail would reach him. . . .” (Emphasis supplied.)

The second count omits the word “*unlawfully*”, which is used twice in the first count. The second count, in effect, simply accuses the defendant of “*knowingly*” having failed and neglected to keep the local board advised of the address where mail would reach him.

## Assignment of Errors and Points Upon Which Appellant Relies in This Appeal.

### I.

THE MOTION IN ARREST OF JUDGMENT SHOULD HAVE BEEN GRANTED AND ALLOWED. THE SECOND COUNT OF THE INDICTMENT ON WHICH THE DEFENDANT WAS TRIED AND CONVICTED FAILS TO STATE AN OFFENSE.

### II.

THE DISTRICT COURT ERRED IN ITS OPINION, DECISION AND DETERMINATION IN DENYING THE MOTION IN ARREST OF JUDGMENT.

### I.

**The Motion in Arrest of Judgment Should Have Been Granted and Allowed. The Second Count of the Indictment on Which the Defendant Was Tried and Convicted Fails to State an Offense.**

The United States Attorney, and the District Court have considered only the first sentence of the regulation, as follows:

“It shall be the duty of each Registrant to keep his Local Board advised at all times of the address where mail will reach him.”

They have failed to consider this regulation as a whole. They fell into the error of completely misapprehending its meaning and effect, and, therefore, of assuming that the regulation imposed the duty of keeping the Board advised from day to day of Registrant's whereabouts and that the failure to do so constituted an offense.

The reading of the regulation as a whole in the light of the Selective Training and Service Act of 1940, its pro-

visions and purposes, makes quite clear the fact that the regulation had one purpose and effect and one only. That purpose and effect was to advise the Registrant that the Board would rely in sending out its communications upon the address last given and if he did not want to continue to use that address, he should advise it of any change. It had neither the purpose nor the effect of making it an offense for the Registrant to stick to his original address.

This is the regulation in whole:

641.3 *Communication by mail.* It shall be the duty of each Registrant to keep his local Board advised at all times of the address where mail will reach him. *The mailing of any order, notice, or blank form by the local board shall constitute notice to him of the contents of the communication, whether he actually receives it or not.*" (Emphasis supplied.)

What it intends to, and does, accomplish, is this: When the registrant gives his address at the time of registration, he must expect that address to serve as the one for the Board to communicate with him by, and if he doesn't notify the Board of a change of address, he must expect to be bound by notices sent to that address whether he receives them or not, and to abide the consequences of their sending though they were not received. Thus the regulation puts the responsibility for his failure to actually receive notices upon the registrant and not upon the Board, and it instructs him that if he wants to be sure that he will actually and not merely constructively receive notices, he must keep the Board advised of change of address. At the same time, it tells him that his last reported address will be a sufficient address for all the purposes of the Board and that the mailing of any order or communication to the last address given by him shall constitute notice to him and lay

him liable for prosecution for failure to obey it whether or not he actually receives the notice. If in this case the Board mailed his notice of induction to the last address he gave, he would have been without defense to the first count for, constructively presumed to have received his notice, he was under the imperative duty to report for induction at the time named in it, and apparently he did not report.

But before the commencement of the trial, on the Motion of the United States Attorney, the first count accusing the defendant of having "knowingly and unlawfully" failed to report for induction was dismissed by the District Court.

The charge made against him under the second count that he did not keep the Board advised of an address where mails could reach him states no offense at all. For the regulation invoked expressly provided that the Board will always mail to his last address given, and that he will be conclusively presumed to have received notices sent by the Board to that address. Any failure, therefore, to keep the Board advised of a change of address is not a failure of duty for which he can be indicted as a criminal, it is merely a failure of self protection as a result of which he may find himself subject to indictment as a criminal for failure to obey an order or communication, notice of which he did not actually receive. Yet he was prosecuted, nevertheless, and convicted. The Motion in Arrest of Judgment should have been granted by the District Court and Count Two dismissed as charging no offense, and even if a felony offense could be pleaded for failure to keep his local Board advised at all times of the address where mail would reach him, Count Two utterly fails to accuse him of criminal intent so to do.

II.

The District Court Erred in Its Opinion, Decision and Determination in Denying the Motion in Arrest of Judgment.

The second count of the indictment accuses the defendant as follows:

“ . . . the said defendant did *knowingly* fail and neglect to perform a duty required of him under said act and the rules and regulations promulgated thereunder, in that he did then and there *knowingly* fail and neglect to keep said Local Board No. 129 advised of the address where mail would reach him. . . .”

No reported decision has been found in any of the Circuit Courts nor in the Supreme Court approving a felony indictment which omitted all of the words “feloniously”, “willfully” and “unlawfully” and contained merely “knowingly”. The courts speak of “knowingly” because that is the only one of those four words which is contained in the statute and the regulations. But elsewhere in the decisions, if the actual language of indictments is quoted, we find that in every instance the words “unlawfully” or “willfully” appear in the body of all of the felony indictments. More often the words are “willfully”, “unlawfully” and “knowingly”. Sometimes all four appear, *i. e.* “feloniously”, “willfully”, “unlawfully” and “knowingly”.

Mr. Justice Reed in delivering the opinion of the Court in:

*Bartchy v. United States*, decided June 7, 1943, 319 U. S. 484,

states in the opening paragraph of that opinion:

“This case presents the question of the sufficiency of the evidence to support petitioner’s conviction under Section 11 of the Selective Training and Service



Act and the regulations made thereunder for a *knowing* failure to keep his local board advised of the address where mail would reach petitioner, a registrant under the Act. . . . Certiorari was granted because the conviction involved an interpretation of an important regulation under the Selective Service Act; 318 U. S. 754, *ante*, 1129, 63 S. Ct. 980.”

“With the approval of both parties and the Court, petitioner was tried by the Court without a jury and upon conviction was sentenced to imprisonment for sixty days. The Circuit Court of Appeals *affirmed*, one judge dissenting.” (Emphasis supplied.)

Mr. Justice Reed does not mention the form of, nor quote the language of, the body of the Indictment, probably because the Court concluded to reverse the conviction on the insufficiency of the evidence.

The “one judge dissenting” in the Circuit Court of Appeals, 5th Circuit, Circuit Judge Hutcheson, states in his vigorous and lucid dissent as follows:

“The second count charged that the defendant was registered with Local Draft Board No. 9 . . . (and) . . . that it was his duty to keep the draft board advised at all times of the address where mail would reach him, and that, in violation of that duty, he *knowingly, willfully and feloniously* did fail and neglect to keep the local draft board so advised.” (Emphasis supplied.)

*Bartchy v. United States*, decided December 23, 1942 (C. C. A. 2nd), 132 F. (2d) 348 at page 349,

and Circuit Judge Hutcheson proceeds in his dissenting opinion at page 349 to say:

“Defendant demurred to the indictment and each count thereof. The demurrers overruled, he pleaded

not guilty, and upon his request with the approval of the Court and the United States Attorney, a jury was waived and all questions of fact as well as law were submitted to the Court. . . . Appellant is here insisting that his demurrer to count two of the indictment was well taken and that that count should have been dismissed. He makes the further insistence that, the evidence, without conflict, every fact testified to consistent with every other fact, no witnesses disputing the testimony of any other, the facts thus disclosed are wholly insufficient to establish beyond a reasonable doubt that appellant failed to keep his local draft board advised at all times of the address where mail would reach him. I think it *clear beyond any possibility of doubt both* that the *second count* of the *indictment states no offense and that, if it does*, the evidence fails to establish its commission." (Emphasis supplied.)

Judge Hutcheson's dissent was approved by the Supreme Court as to his latter expression, to-wit: "the evidence fails to establish its Commission" but unfortunately the Supreme Court is silent concerning the sufficiency of the second count of the indictment which the petitioner and Judge Hutcheson claimed "states no offense." The Supreme Court tactfully refrained from expressing either approval or disapproval of the form of sufficiency of the indictment.

We call Judge Hutcheson's statement to the attention of this court to illustrate that the indictment charged Bartchy, the petitioner, with criminal intent by the allegations "*knowingly*", "*willfully*" and "*feloniously*" coupled with the allegations of fact. Yet a first reading of Mr. Justice Reed's very first paragraph in the decision of *Bartchy v. United States, supra*, would tend to mislead a

person into believing that the Bartchy indictment simply accused Bartchy of “knowingly” having failed, etc. Whereas, in truth and in fact, according to Judge Hutcheson all three words, “*knowingly*”, “*willfully*” and “*feloniously*” were a part of the body of that indictment. It is hoped that a certified copy of the indictment in the *Bartchy* case can be produced by the Appellant in Court at the hearing of this appeal.

Judge Hutcheson further states in the same dissenting opinion at p. 350:

“The Government, the District Judge, and the majority considering only the regulation, ‘It shall be the duty of each Registrant to keep his local board advised at all times of the address where mail will reach him’, and failing to consider it as a whole, fell into the error of completely misapprehending its meaning and effect, and therefore, of assuming that the regulation imposed the duty of keeping the Board advised from day to day to do so constituted an offense.”

The Supreme Court does not adopt that language of Judge Hutcheson but at page 489 of the *Bartchy* decision states:

“The District Court and the Court of Appeals concluded that the petitioner had not shown diligence in keeping the board advised of his whereabouts and had *affirmatively* endeavored to avoid delivery of the communication. We do not think either of these inferences is justified by the record.” (Emphasis supplied.)

The Supreme Court in the *Bartchy* decision concludes by stating:

“Petitioner might have been more diligent by telephoning or calling at the union at intervals between the twenty-fifth of February and the tenth of March

but we conclude that he was justified in relying upon the efficiency of this experienced organization to advise him of the arrival of the notice. *Reversed.*" (Emphasis supplied.)

Following the reversal by the Supreme Court the reports are silent as to any further attempted prosecution of Mr. Bartchy. Probably the indictment was dismissed and the registrant allowed to accept voluntary induction into the armed forces of the United States.

In *U. S. v. Cruikshank* (92 U. S. 542, 557, 558, 23 L. ed. 588) the Supreme Court said:

"In criminal cases, prosecuted under the laws of the United States, the accused has the constitutional right 'to be informed of the nature and cause of the accusation.' Amend. VI. In *U. S. v. Mills*, 7 Pet. 142, this was construed to mean, that the indictment must set forth the offense 'with clearness and all necessary certainty, to apprise the accused of the crimes with which he stands charged;' and in *U. S. v. Cook*, 17 Wall. 174, that 'every ingredient of which the offense is composed must be accurately and clearly alleged.' It is an elementary principle of criminal pleading, that where the definition of an offense, whether it be at common law or by statute, 'includes generic terms, it is not sufficient that the indictment shall charge the offense in the same generic terms, as in the definition; but it must state the species,—it must descend to particulars.' (1 Arch. Cr. Pr. and Pl., 291.) The object of the indictment is, first, to furnish the accused with such a description of the charge against him as will enable him to make his defense, and avail himself of his conviction or acquittal for protection against a further prosecution for the same cause; and, second, to inform the court of the facts

alleged, so that it may decide whether they are sufficient in law to support a conviction, if one should be had. For this, *facts are to be stated, not conclusions of law alone*. A crime is made up of acts and intent; and these must be set forth in the indictment, with reasonable particularity of time, place and *circumstances*."

"It is a crime to steal goods and chattels; but an indictment would be bad that did not *specify with some degree of certainty the articles stolen*. This, because the accused must be advised of the essential particulars of the charge against him, and *the court must be able to decide whether the property taken was such as was the subject of larceny*." (Emphasis supplied.)

As stated in *U. S. v. Cruikshank, supra*, "It is not sufficient that the indictment shall charge the offense in the same generic terms as in the definition; but it must state the species,—*it must descend to particulars*." There is no allegation in Count Two of this indictment to inform the defendant that he is accused of failing to furnish a new address subsequent to his registration with the local board. As far as the allegations in the indictment are concerned, he may have furnished a chain of new addresses, as in the *Bartchy* case. The United States Attorney was certainly in possession of the facts prior to the drafting of the indictment. If these facts indicated that the defendant, KENTON GEORGE SCHULTZ, "willfully" attempted to delay his induction into the armed forces of the United States by a scheme, either of giving false addresses, or of no addresses at all, then he should have been accused accordingly. The indictment should have included some of these facts or, if the pleader preferred to use legal conclusions, then he should have, at least, inserted the word "willfully". It

is for that reason that felony pleadings have contained the words “feloniously”, “willfully”, “unlawfully” and often other legal conclusions in addition to detailed facts as to time, place and circumstances. Such allegations accuse the defendant of criminal intent. All of these allegations are often contained in felony indictments in addition to the simple recitation of the language of the statute creating the offense.

We truly believe, and we contend, that the omission of the word “unlawfully” in the second count of the indictment, after it was used twice in the first count of the indictment, must have been an omission by oversight or a mistake of the typist. We do not think that the United States Attorney deliberately included the word “unlawfully” twice in the first count of the indictment and then with deliberation studiously avoided its use in the second count. However, if the Government should take the position that the word was omitted purposely, then it is an indication of a plan on the part of the pleader to avoid his duty to descend to particulars with allegations of fact which could replace the usual legal conclusions “willfully” and “unlawfully”. If the Government takes that position, it would indicate that the Government elected to dismiss the first count of the indictment and to rely upon the second count because it became easier to convict with the word “unlawfully” omitted. The word “unlawfully” may be the equivalent of the word “willfully”.

Certainly doing a thing “knowingly and willfully” implies not only knowledge of the thing but a determination with an evil intent to do it or to omit doing it.

*Hiatt v. Tomlinson*, 100 Neb. 51, 158 N. W. 383,  
384.

With respect to liability for punishment for contempt, doing or omitting to do a thing “knowingly and willfully” implies not only a knowledge of the thing, but a determination with a bad intent to do it or to omit doing it.

*State ex rel. Grove v. Grove*, 158 Oregon 635, 77 P. (2d) 430, 432.

The court in the “*per curiam*” opinion of:

*United States v. Trypuc*, decided June 11, 1943 (C. A. 2nd), 136 F. (2d) 900,

at page 901 says:

“But an examination of the charge convinces us that the issue whether the appellant ‘knowingly’ failed to keep the board advised of an address where mail would reach him was not properly submitted to the jury.”

The fact is that in the very same opinion it becomes crystal clear (first paragraph) that the indictment in that case contained the word “unlawfully” as well as “knowingly”.

“The indictment charged that being under such duty, the appellant did ‘unlawfully and knowingly’ fail and neglect to perform it.” *United States v. Trypuc (supra)*. The conviction in the *Trypuc* case was reversed upon the authority of *Bartchy v. United States (supra)*.

The conviction obtained under the second count in the instant case without a correct and requisite allegation of criminal intent is erroneous and in violation of Amendment VI of the Constitution.

## Conclusion.

It is true that criminal pleadings in the United States courts are being simplified from time to time, or perhaps they are being "streamlined". No defendant can quarrel with the Government over a simplified or a "streamlined" indictment provided the indictment contains allegation of facts lucidly, succinctly and completely stated which accuse and inform him fully of the "nature and cause of the accusation". With respect to simplified criminal pleadings, however, it is well to recall to mind the words of Mr. Justice Bradley in deciding the case of *Boyd v. U. S.*, 116 U. S. 616, 29 L. Ed. 746 at p. 752, where he declared:

"It may be the obnoxious thing in its mildest and least repulsive form; but illegitimate and unconstitutional practices get their first footing in that way, namely: by silent approaches and slight deviations from legal modes of procedure. This can only be obviated by adhering to the rule that constitutional provisions for the security of *persons* and property should be liberally construed. . . . It is the duty of the courts to be watchful for the constitutional rights of the citizen, and against any stealthy encroachments thereon. Their motto should be '*obsta principiis*'." (Emphasis supplied.)

The Latin phrase "*obsta principiis*" was uttered almost nineteen centuries ago by the Roman poet Ovid. The present day English equivalent probably is "Withstand Beginnings".

Before we begin to attempt in the United States Courts to plead criminal intent with one single legal conclusion, "knowingly", without, in addition, descending to particulars and alleging facts as to the circumstances of the alleged criminal act, we should apply soberly the motto:



*“obsta principiis”*. Surely it was not the intention of the Congress in passing the Selective Training and Service Act of 1940 to create felons but to mobilize a military force in defense of our beloved country. Citizens must not be permitted to lose their civil rights and become branded as common felons simply to uphold simplified or “streamlined” indictments which wholly fail to state any offense. Let all of us “withstand beginnings” in the disintegration of Constitutional rights by discharging our Constitutional duties.

No man, under our Constitution, is guilty of a felony unless he has acted with an exercise of his free will and has “willfully” committed a felonious crime. Consequently, the felony indictments in the United States Courts have uniformly contained, at the very least, the legal conclusion “willfully” or its equivalent by a recitation of facts. Acts alone are not in themselves sufficient. The Acts must be accompanied by accusations of criminal intent. It must appear in the body of a felony indictment that the accused acted with criminal intent or with a wicked or bad purpose.

The District Court erred in denying the Motion in Arrest of Judgment. The judgment and sentence was based upon the fatally defective and insufficient second count of the indictment. No criminal intent is pleaded therein either by legal conclusion or by recitation of facts to show criminal intent or a wicked or bad purpose.

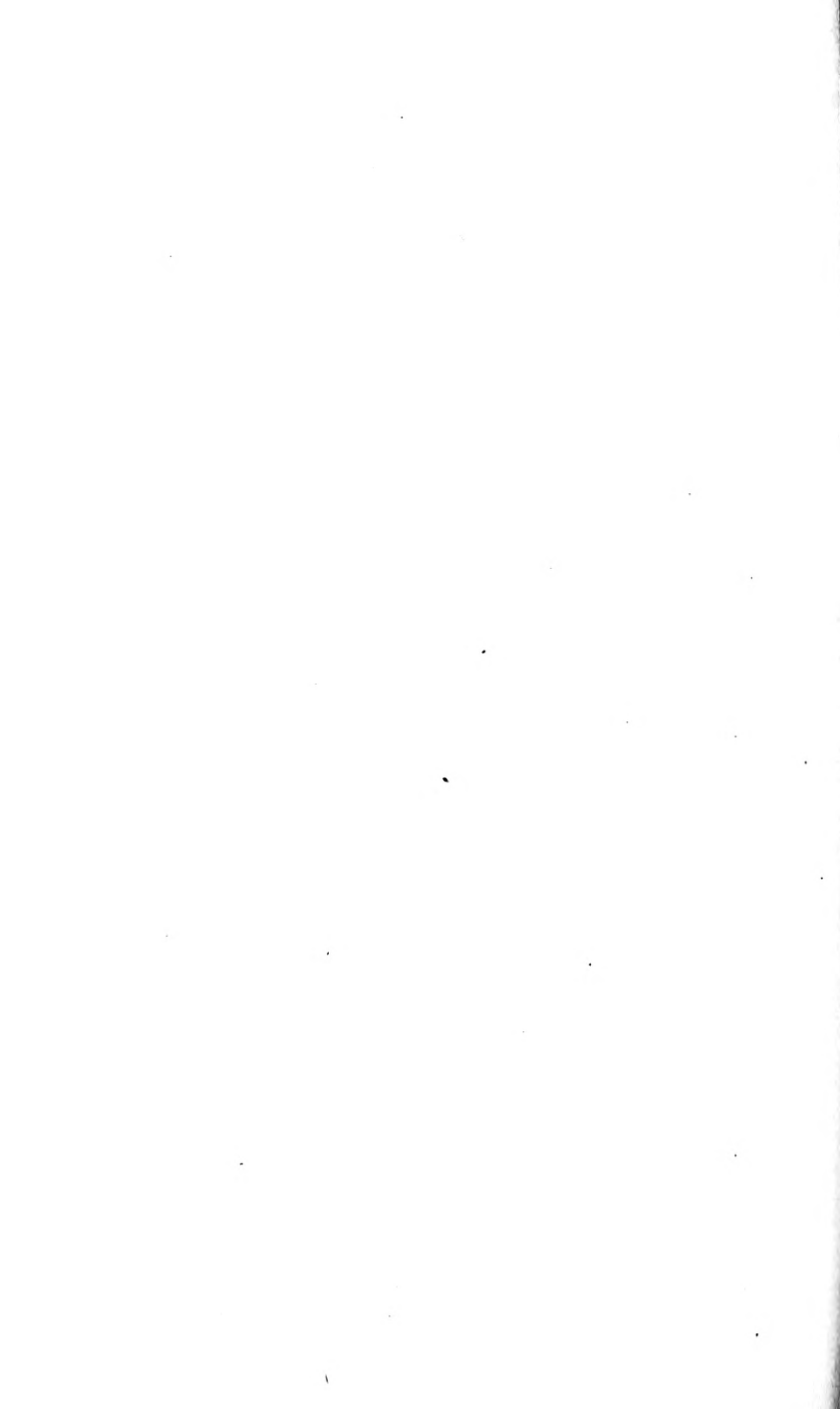
Yet the appellant faces eighteen months in an institution of the penitentiary type.

The judgment should be reversed.

Respectfully submitted,

MAURICE NORCOP,

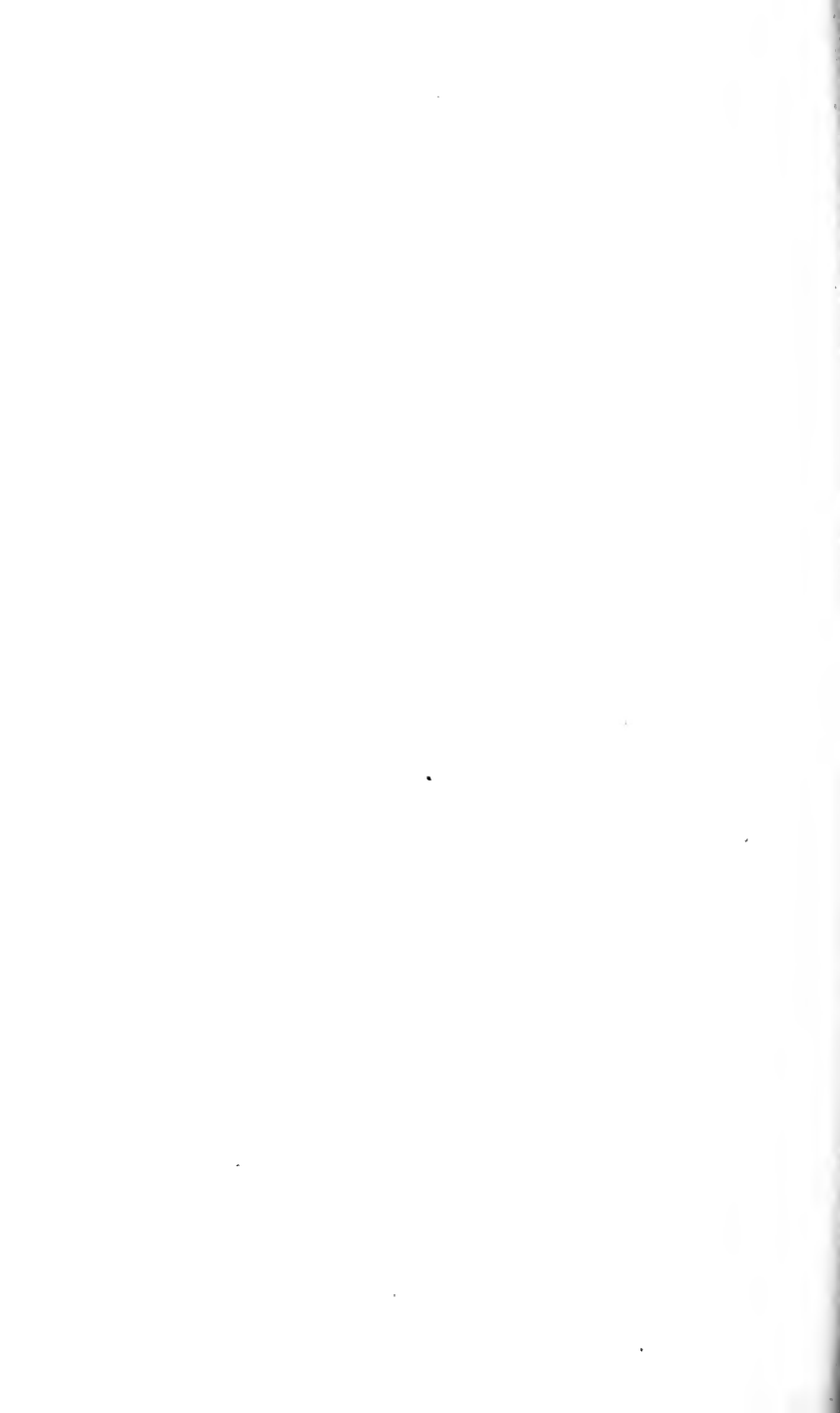
*Attorney for Appellant.*



## APPENDIX.

Section 11 of the Selective Training and Service Act punishes with a maximum of five years imprisonment and a fine of not more than \$10,000.00 "any person . . . who in any manner shall knowingly fail or neglect to perform any duty required of him under or in the execution of this Act, or rules or regulations made pursuant to this Act. . . ." (September 16, 1940), 54 Stat. 885, 894, c. 720, 50 USCA Appx. 311, 11 FCA title 50, Appx. 5, 11.

The regulation involved provides: "Section 641.3 *Communication by mail*. It shall be the duty of each registrant to keep his local board advised at all times of the address where mail will reach him. The mailing of any order, notice, or blank form by the local board to a registrant at the address last reported by him to the local board shall constitute notice to him of the contents of the communication, whether he actually receives it or not." 6 Fed. Reg. 6851-52."



No. 11171.

IN THE

United States Circuit Court of Appeals  
FOR THE NINTH CIRCUIT

---

KENTON GEORGE SCHULTZ,

*Appellant,*

*vs.*

UNITED STATES OF AMERICA,

*Appellee.*

---

APPELLEE'S BRIEF.

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*United States Attorney,*

JAMES M. CARTER,

*Assistant United States Attorney,*

WILLIAM STRONG,

*Special Assistant to the United States Attorney,*

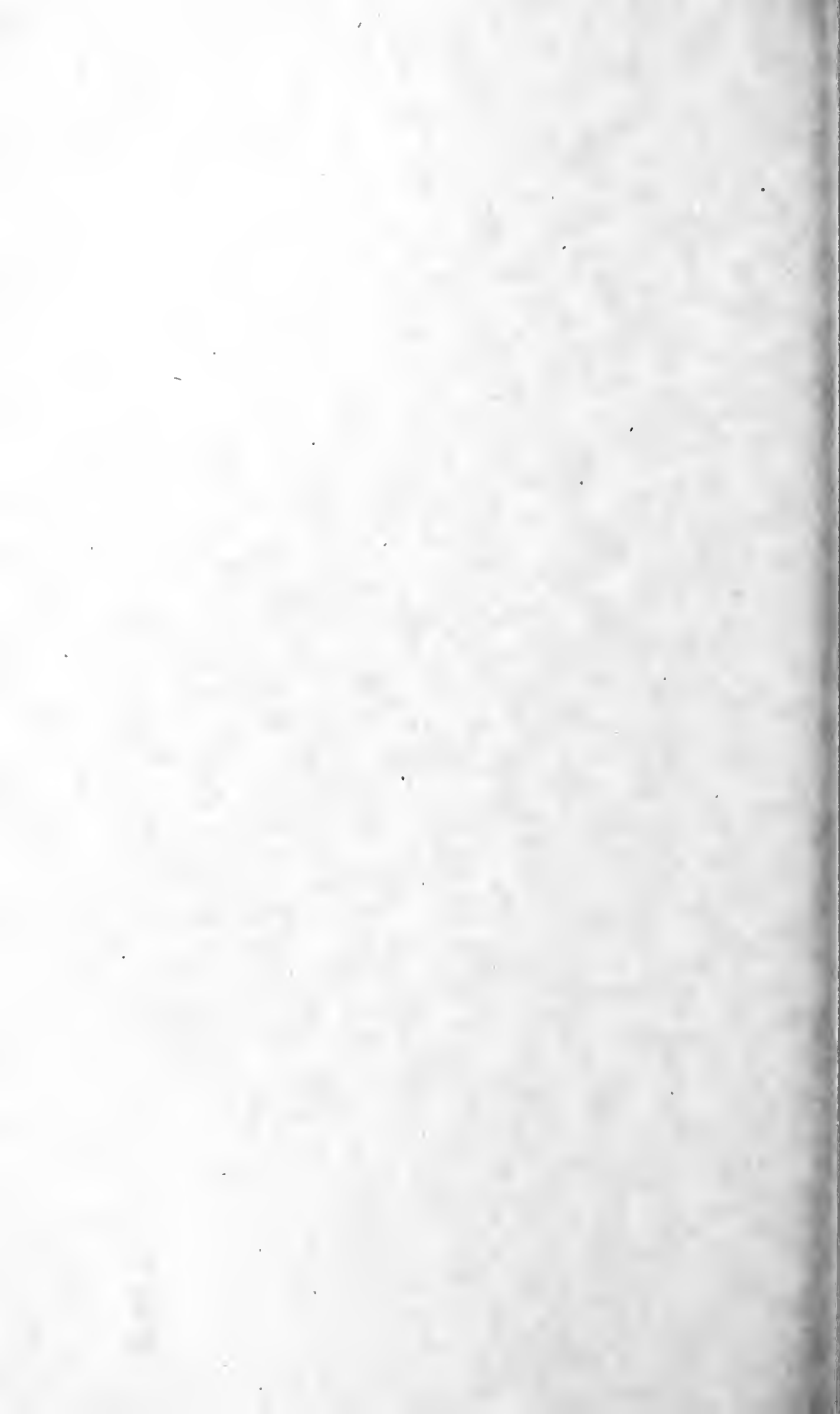
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APR 26 1946



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No. 11171.

IN THE

**United States Circuit Court of Appeals**  
FOR THE NINTH CIRCUIT

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KENTON GEORGE SCHULTZ,

*Appellant,*

*vs.*

UNITED STATES OF AMERICA,

*Appellee.*

---

**APPELLEE'S BRIEF.**

---

**Jurisdiction.**

Appellant was indicted under Section 11 of the Selective Training and Service Act of 1940, 54 Stat. 885 (50 U. S. C. App. 311) [R. 2-4].<sup>1</sup> The District Court had jurisdiction under Section 24 of the Judicial Code (28 U. S. C. 41(2)). Judgment was entered on October 23, 1945 [R. 9-10]. Notice of appeal was filed on October 25, 1945 [R. 10-11]. This Court has jurisdiction under Section 128 of the Judicial Code (28 U. S. C. 225).

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<sup>1</sup>The references preceded by "R" are to the printed record on appeal.

### Statute and Regulation Involved.

Section 11 of the Selective Training and Service Act of 1940 (50 U. S. C. App. 311), provides in part:

“Any person \* \* \* who in any manner shall knowingly fail or neglect to perform any duty required of him under or in execution of this Act, \* \* \* shall, upon conviction in the District Court of the United States having jurisdiction thereof, be punished by imprisonment for not more than five years or a fine of not more than \$10,000.00, or by both such fine and imprisonment. \* \* \*”

Section 641.3 of the Selective Service Rules and Regulations promulgated under the Act provides in part:

“It shall be the duty of every registrant to keep his local board advised at all times of the address where mail will reach him. \* \* \*”

### Statement of the Case.

Appellant was indicted in the United States District Court for the Southern District of California, Northern Division, on about July 11, 1945, in two counts, charging violations of the Selective Training and Service Act of 1940 (*supra*) [R. 2-4], herein called the Act, in that he (a) had failed to report for induction into the Armed Forces as ordered by his draft board [R. 2-3], and (b) had failed to keep his local draft board advised of his address [R. 3-4], thereby knowingly failing to perform duties required of him by the Act and rules and regulations promulgated under it.

Count 1 of the indictment was dismissed prior to trial [R. 5].<sup>2</sup>

Appellant was then tried before the District Court judge and a jury upon Count 2 of the indictment, and was found guilty by the jury as to that count [R. 9].<sup>3</sup>

Following denial of appellant's motion in arrest of judgment, on October 23, 1945, the District Court sentenced appellant to imprisonment for a term of 18 months [R. 4-5, 8-10].

Appellant filed a notice of appeal and grounds of appeal on October 26, 1945 [R. 10-11], and an assignment of errors on January 11, 1946 [R. 12].

### Questions Presented.

The sole issues before this Court are (1) whether it is a violation of the Act for a registrant to knowingly fail to keep his local draft board advised at all times of the address where mail will reach him, and (2) whether Count 2 of the indictment sufficiently states such an offense under the Act.

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<sup>2</sup>Appellant objected to the dismissal of Count 1, and also entered an exception [R. 5.]

<sup>3</sup>The record on appeal does not indicate what plea was entered by appellant to the indictment. The record is also incomplete in other respects.

## ARGUMENT.

Appellant argues in effect (a) that under the Act a registrant has committed no violation by failing to keep his local draft board advised at all times of the address where mail will reach him (A. B. 3-5),<sup>4</sup> and (b) that Count 2 of the indictment does not state such an offense under that Act (A. B. 6-14).

Both contentions are patently without merit.

### A.

Little need be said in answer to the appellant's contention (A. B. 3-5) that his failure to keep his local draft board advised at all times of his address, is not a crime.

The statute expressly makes it a crime for any person in any manner to "knowingly fail or neglect to perform any duty required of him under or in execution of this Act or rules or regulations made pursuant to this Act \* \* \*."

Regulation 641.3 specifically provides that:

"It shall be the duty of every registrant to keep his local board advised at all times of the address where mail will reach him."

The Supreme Court and other courts have indicated that failure to comply with this specific provision is a crime under the Act. See *e. g.*, *Bartchy v. United States*, 319 U. S. 484, reversing the decision below on other

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<sup>4</sup>The references preceded by "A. B." are to the appellant's brief.

grounds (see *infra*, p. 8); *Bartchy v. United States*, 132 F. (2d) 348 (C. C. A. 5); *United States v. Trypuc*, 136 F. (2d) 900, 901 (C. C. A. 2); *United States v. Hoffman*, 137 F. (2d) 416, 419 (C. C. A. 2).<sup>5</sup>

Appellant's contentions in this respect are clearly without substance.

## B.

Appellant asserts (A. B. 6-14) that Count 2 of the indictment does not sufficiently charge the offense of which he was convicted. Appellant's entire argument in this respect is predicated upon his assertions that it is not sufficient to allege in an indictment under the Act that the defendant "knowingly" failed to perform the duty required of him under that statute. According to appellant, the indictment should have alleged in addition that he had acted or failed to act "unlawfully," "wilfully," and "feloniously."

This contention is patently baseless.

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<sup>5</sup>It should be noted at this point that almost all of appellant's argument in this connection, beginning in the middle of page 3 and continuing thereafter to line 8 from the bottom on page 5, of his brief, has been lifted practically verbatim from Judge Hutcherson's dissenting opinion in *Bartchy v. United States*, 132 F. (2d) 348, 349 (C. C. A. 5), which we discuss more fully below (p. 8, *infra*). Although the majority decision was later reversed by the Supreme Court because of the lack of substantial evidence to support the verdict, the majority's holding that it is a violation of the Selective Training and Service Act of 1940 for a registrant to fail to keep his draft board advised of his address, was nonetheless upheld.

Manifestly it is wholly improper for appellant to seek to foist upon this Court a dissenting opinion rejected in that respect by the Supreme Court.

It is established law, requiring no citation of authorities, that a statutory offense may be charged in an indictment in the language of the statute.<sup>6</sup>

As this Court in part pointed out in *Zuziak v. United States*, 119 F. (2d) 140, 141 (C. C. A. 9), which involved a criminal prosecution under Section 11 of the Selective Training and Service Act of 1940, the same as in this case:

“Section 11, 50 U. S. C. A. § 311, ‘provides that any person who *knowingly* evades registration or fails or neglects to perform any duty devolving upon him under the Act or the regulations, shall, upon conviction of such offense, be subject to fine or imprisonment, or both.’ (Italics ours.)

In *Moore v. United States*, 128 F. (2d) 974 (C. C. A. 5), the defendant was indicted and convicted for “knowingly hindering and interfering by force and violence with the administration of the Selective Training and Service Act of 1940” (p. 975), the same statute as in the instant case except that the prosecution was under a different section; that section, however, also makes it a crime for an individual to act “knowingly” in the proscribed manner (see 50 U. S. C. App. 311). In overruling the arguments of the appellant Moore, the Court in that case stated, with specific reference to Moore’s contention that his demurrer to the indictment should be sustained.

“The function of an indictment is to apprise a defendant fully and clearly of the nature and extent of

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<sup>6</sup>See, *c. g.*, *Ledbetter v. United States*, 170 U. S. 606; *Taran v. United States*, 88 F. (2d) 54, 56 (C. C. A. 8).

the charges made against him, so that he will be enabled to make his defense, and, after judgment, plead the judgment in bar of further prosecution for the same offense. This indictment followed the language of the statute painstakingly, and particularized with exactness the acts relied upon to sustain the charge. It is difficult to conceive how the indictment could more lucidly have advised the defendant of the precise crime charged, or in what way it might have been misleading, and we think the demurrer to the indictment was properly overruled."

See also *United States v. Collura*, 139 F. (2d) 345 (C. C. A. 2), also a case under this Act.

In *Bartchy v. United States*, 132 F. (2d) 348, the majority opinion in part held that:

"Appellant, a registrant under the Selective Training and Service Act of 1940, U. S. C. A. Appendix, § 301, *et seq.*, was found guilty of knowingly failing to keep his local draft board advised at all times of the address where mail would reach him, in violation of Section 11 of the Act. The only decisive question is whether there was substantial evidence to support the finding of the court below, the case having been tried without a jury.

"Article 641.3 of the selective service regulations, promulgated under Section 10 of the Selective Training and Service Act of 1940, places an affirmative duty upon every registrant under the Act to keep his local draft board advised at all times of the address where mail will reach him. The finding of the court below that appellant failed in the discharge of his duty is supported by substantial evidence."

Judge Hutcheson in a dissenting opinion relied upon heavily by appellant (A. B. 3-5), in effect held that the activities of the defendant, even if accepted as found by the District Court, would not constitute a violation of the Act within the meaning of the section in question, and further held that the evidence was not sufficient to support a finding of guilty, even if the acts would constitute such a violation.

The Supreme Court, however, in reversing (319 U. S. 484) the majority opinion of the Circuit Court in the *Bartchy* case, did so wholly upon the basis of insufficiency of the evidence. In doing so, moreover, the Supreme Court clearly indicated that under that statute a registrant is guilty of an offense if it is merely shown that he "knowingly" failed or neglected to keep his local board advised at all times of the address where his mail will reach him.

It is obvious, therefore, that Judge Hutcheson's dissenting opinion can in nowise aid this Court in its determination in this case, and that appellant's heavy reliance upon that opinion merely tends to accent the utter lack of any judicial or rational support for his contentions along the lines which he offered here.<sup>7</sup>

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<sup>7</sup>It should be noted at this point that the appellant in this case has made no issue of the sufficiency of the evidence, upon which he was found guilty by a *jury*. The appellant is, therefore, in no position now to raise any question which is bottomed in any respect upon the evidence or the facts in this case. In the present posture of this case and the record on appeal, it must be conclusively presumed by this Court that the evidence in this case fully supports the strongest possible case from the Government's standpoint, and that the appellant committed the most flagrant violation possible under the Act which could be established under the indictment in this case. As a result, no proposition of law which is to be tested by the sufficiency or the totality of the evidence can be applied to this case in favor of appellant.



Moreover, Judge Hutcheson, after the Supreme Court decided this case, changed his mind upon the question of a registrant's guilt under the Act where he fails to keep his local board advised of his address. *Stumpf v. Sanford*, 145 F. (2d) 270 (C. C. A. 5), cert. denied, 65 S. Ct. 1012.<sup>8</sup>

The opinion of the Second Circuit in *United States v. Trypuc*, 136 F. (2d) 900, mentioned by appellant (A. B. 13), is likewise of no aid to him. In that case the Court, in reversing the judgment of conviction below, held that the issue of whether the appellant "knowingly" failed to keep his local board advised of his address, had not been properly submitted to the jury. We concede that if the District Court in this case had failed to submit such an issue to the jury, a serious question would be presented on appeal. However, there is nothing in this case to indicate that this issue had not been properly submitted below. And while appellant seeks to strain the holding in the *Trypuc* case to support his contention that the indictment must contain other terms besides "knowingly," examination of that decision reveals that appellant's argu-

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<sup>8</sup>Judge Hutcheson in that case states:

"The contentions, overruled by the District Judge and urged here, are that it is no offense against the law to fail to notify the local board of a change of address.

"That a registrant's *wilfully* failing to keep his local board advised of a change of address is a crime, we held in *Bartchy v. U. S.*, 5 Cir., 132 F. (2d) 348, reversed for lack of sufficient evidence, 319 U. S. 484, 63 Sup. Ct. 1206, 87 L. Ed. 1534."

It is obvious that Judge Hutcheson's use of the word "wilfully" in this case is an inadvertance; he plainly meant "knowingly."

ment in this connection again is without substance. As the Court says in that case (at page 901):

“\* \* \* But an examination of the charge convinces us that *the issue whether the appellant ‘knowingly’ failed to keep the board advised of an address where mail would reach him* was not properly submitted to the jury. \* \* \* Not every failure to perform a duty imposed by the statute or regulations is made criminal; *only a person ‘who shall knowingly fail or neglect’ his duty is to be punished.*” (Italics ours.)

See also, *United States v. Hoffman*, 137 F. (2d) 416, 419 (C. C. A. 2), to the same general effect.

Manifestly, under the Selective Training and Service Act of 1940 an offense is properly stated when the indictment charges that a defendant “knowingly” failed or neglected to perform an act required of him; the terms “wilfully,” “feloniously” or “unlawfully” are wholly unnecessary and are properly omitted from such an indictment. And support for the latter proposition is found in the authorities which appellant himself cited and quoted in his “authorities in support of motion” in arrest of judgment [R. 6], filed by him below. Thus, quoting from appellant’s “authorities”:

“The general rule is that the term ‘wilfully’ cannot be omitted from an indictment *when the term is part of a statutory definition.*” (Italics ours.)

Wharton’s Criminal Procedure (10th Ed.), Vol. 1, §§ 285 and 318;

*Rumley v. United States*, 293 Fed. 532 at p. 547 [7].

“\* \* \* The indictments charged in part that these defendants well knowing the premises aforesaid,

unlawfully did 'knowingly' act. This amounts to an allegation of unlawful intent."

*United States v. Altman*, 8 Fed. Supp. 880 at 884.

"\* \* \* and it is also generally held that words which import an exercise of the will, such as 'feloniously' and 'unlawfully' will, supply the place of the word 'wilfully.'"

"\* \* \* Where the facts alleged necessarily import wilfulness, the failure to use the word is not fatal to the indictment."

*Van Gesner v. United States*, 153 Fed. 46.

Of course, it need hardly be mentioned, that the mere fact that some indictments contain a complete collection of the terms which appellant argues are essential in every case, is no test of their essentiality. The question is merely what is actually required in an indictment, not how much can be included. See, *e. g.*, also *Bannon v. United States*, 156 U. S. 464; *Myres v. United States*, 256 Fed. 779 (C. C. A. 5); *Bowen v. Johnson*, 97 F. (2d) 860 (C. C. A. 9), *aff'd.*, 306 U. S. 17; *Howenstine v. United States*, 263 Fed. 1 (C. C. A. 9); *Rumley v. United States*, 293 Fed. 532 (C. C. A. 2), *cert. den.* 363 U. S. 713.

Here, as in the *Zusiak* case, *supra*;

"It is obvious that the indictment fully informed the accused of the nature of the charge so as to enable him to prepare any defense he might have. That is the office of an indictment and nothing more specific in the matter of form is required of it. 18 U. S. C. A. § 556. The indictment states an offense under the statute."

### Conclusion.

The acts charged in the indictment constitute an offense under the Act. The indictment sufficiently charges such an offense. Appellant was found guilty by a jury, and no reason appears for disturbing the jury's verdict or the judgment below. The judgment should be affirmed.

Respectfully submitted,

CHARLES H. CARR,

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*Special Assistant to the United States Attorney,*

MILDRED L. KLUCKHOHN,

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No. 11173

---

United States  
Circuit Court of Appeals

For the Ninth Circuit.

---

SECURITIES AND EXCHANGE COMMIS-  
SION,

Appellant,

vs.

THE PENFIELD COMPANY OF CALIFOR-  
NIA and A. W. YOUNG,

Appellees.

---

Transcript of Record

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Upon Appeal from the District Court of the United States  
for the Southern District of California,  
Central Division

FILED

DEC 28 1945

PAUL P. O'BRIEN,  
CLERK



No. 11173

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United States  
Circuit Court of Appeals

For the Ninth Circuit.

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SECURITIES AND EXCHANGE COMMIS-  
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Central Division





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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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In the District Court of the United States for the  
Southern District of California, Central Division

Civil Action No. 2863-P.H.—Civ.

SECURITIES AND EXCHANGE COMMISSION,

Applicant,

vs.

THE PENFIELD COMPANY OF CALIFORNIA,

Respondent.

AFFIDAVIT IN SUPPORT OF RULE TO  
SHOW CAUSE WHY A. W. YOUNG, SECRETARY-TREASURER, PENFIELD COMPANY OF CALIFORNIA, SHOULD NOT BE ADJUDGED IN CONTEMPT

State of California,  
County of Los Angeles—ss.

Charles R. Burr, being first duly sworn, does on oath depose and say that:

I.

On April 13, 1943, there was filed in this Court by the Applicant (hereinafter referred to as the Commission) a document entitled "Application for Order to Require Witness to Appear and Produce Documentary Evidence," which recited, among other things, that the Commission had on May 14, 1942, pursuant to Section 20(a) of the Securities

Act of 1933, as amended (15 U.S.C. 77t(a)), ordered that an investigation be made as to the facts and circumstances concerning possible violations by Bourbon Sales Company and others of Sections 5(a) and 17(a) (18 U.S.C. § 77(e) and 77(q)) of said Act. The application [2] further alleged that the Commission, on April 8, 1943, amended its order of May 14, 1942, by extending the investigation to also cover facts and circumstances concerning alleged violations by Penfield Company of California of the aforementioned Sections of the Act. It was further alleged that the said Commission orders of May 14, 1942, and April 8, 1943, pursuant to the provisions of Section 19(b) of said Act (15 U.S.C. 77(s) (b)), appointed officers for the purpose of that investigation and empowered them to administer oaths or affirmations, subpoena witnesses, compel their attendance, and require the production of any books, papers, correspondence, memoranda, and records deemed relevant to the inquiry.

## II.

It was further alleged in said Application that, pursuant to the powers and duties arising from the aforementioned Commission orders, C. J. Odenweller, Jr., a duly designated officer of the Commission, thereafter caused to be issued a subpoena duces tecum requiring the production before him of certain described books and records of the Penfield Company of California, at 1737 United States Post Office and Courthouse Building, Los Angeles, California, on the 10th day of April, 1943, at 10:00

o'clock A.M., and that service of said subpoena was made on April 10, 1943, by personal delivery of a duplicate original thereof to the Attorney for the Penfield Company of California, who agreed to accept service for said company.

### III.

It was further alleged in said Application that the Penfield Company of California refused to appear and produce the books and records as specified and required in the aforementioned subpoena duces tecum and that by such refusal the Penfield Company of California had impeded and was continuing to impede the progress of the Commission's investigation.

### IV.

Upon the filing of the Application, as aforesaid, an order was issued by this Court, directed to the Penfield Company of California, to appear before the Honorable Peirson M. Hall, Judge of the above-entitled Court in the City of Los Angeles on the 19th day of April, 1943, and then and there show cause why [3] an order should not issue as prayed in said Application.

### V.

On the 19th day of April, 1943, said Application came on regularly for hearing before the Honorable Peirson M. Hall, Judge presiding, and such proceedings were had that the Court thereafter, on June 1, 1943, ordered A. W. Young, Secretary-Treasurer of the Penfield Company of California, to appear before C. J. Odenweller, Jr., on the 8th

day of June, 1943, and at any adjournments thereof as might be determined from time to time, then and there to produce the books and records of the Penfield Company of California as described in said order. The said order of June 1, 1943, further ordered that, in accordance with the stipulation and agreement of the parties made in open court, the books and records as aforesaid, in lieu of their physical production, should be made available to such officer and employees of the Commission as might be designated for such purpose at the office of the Penfield Company of California in Los Angeles, California.

#### VI.

Appeal from the said order of this Court on June 1, 1943, was noted by the Penfield Company of California on June 1, 1943, and on the same day proceedings to enforce said order were stayed pending final determination of said appeal.

#### VII.

On November 13, 1944, the mandate of the Circuit Court of Appeals for the Ninth Circuit was issued affirming the said order of this Court dated June 1, 1943, and on December 7, 1944, the said mandate was ordered filed and spread upon the minutes of this Court.

#### VIII.

On January 16, 1945, the order of investigation of the Commission of May 14, 1942, was further amended by the designation of Charles R. Burr, your affiant, and Leo J. Sherman as additional

officers of the Commission, for the purpose of conducting such Commission investigation. A copy of said Commission amended order, dated January 16, 1945, is annexed hereto, marked Exhibit A, and made a part hereof.

### IX.

On January 16, 1945, your affiant, pursuant to the authority conferred [4] upon him under the order of the Commission dated January 16, 1945, addressed and caused to be deposited in the United States mails, a communication to A. W. Young, Secretary-Treasurer of the Penfield Company of California, in the form and content of Exhibit B hereto, annexed and made a part hereof, advising said A. W. Young that your affiant would call at the offices of the Penfield Company in Los Angeles, California, on January 24, 1945, for the purpose of examining the books and records referred to in the order of this Court dated June 1, 1943, a copy of which order was enclosed in said letter. Copies of affiant's letter and enclosure were mailed to A. W. Young at 683 Kelton Avenue, West Los Angeles, California; Morris Lavine, Esq., 20 Bartlett Building, Los Angeles, California; Francis A. Reilly, Esq., 6233 Hollywood Boulevard, Hollywood, California; and Flanagan, Wilson & Thomas, attention of Philip L. Wilson, Jr., 453 South Spring Street, Los Angeles, California.

### X.

On January 24, 1945, affiant, together with Leo J. Sherman, the other officer designated in the



aforementioned Commission's amended order of January 16, 1945, presented themselves at the office of the Penfield Company of California in Los Angeles, California, and demanded to see the books and records referred to in the order of this Court dated June 1, 1943, but such demand was refused.

CHARLES R. BURR.

Subscribed and sworn to before me this 24th day of January, 1945.

[Seal] G. M. CUTHBERTSON,  
Notary Public in and for the County of Los Angeles, State of California. [5]

EXHIBIT A

United States of America

Before the Securities and Exchange Commission

At a regular session of the Securities and Exchange Commission, held at its office in the City of Philadelphia, Pennsylvania, on the 16th day of January, A. D. 1945

In the Matter of

Bourbon Sales Corporation, Penfield Company, L. M. Ulmsted, Eugene Tereny, Harold C. Jordan, Donald F. Crow, Glen A. Tanner, Frank Black, K. A. Shropshire, A. W. Young, Penfield Company of California.

SUPPLEMENTAL ORDER DIRECTING INVESTIGATION AND DESIGNATING OFFICERS TO TAKE TESTIMONY

## I.

On May 14, 1942, the Commission issued an order directing an investigation of Bourbon Sales Corporation, Penfield Company, L. M. Ulmsted, Eugene Tereny, Harold C. Jordan, Donald F. Crow, Glen A. Tanner, Frank Black and K. A. Shopshire to determine whether they had violated the provisions of Sections 5(a) and 17(a) of the Securities Act of 1933, which order was supplemented on February 13, 1943, by naming an additional officer to conduct the investigation. On April 8, 1943, the Commission further supplemented its order and added A. W. Young and the Penfield Company of California as respondents. The order was further supplemented on July 19, 1944, when the Commission named an additional officer to conduct the investigation.

## II.

It Is Hereby Ordered that the order and supplemental orders of the Commission mentioned in paragraph I hereof be and they hereby are further amended by designating Charles R. Burr and Leo J. Sherman as additional officers of the Commission.

By the Commission.

(Signed)            ORVAL L. DUBOIS,  
Secretary. [7]

EXHIBIT B

LAB:JLT/U

12

January 16, 1945

Mr. A. W. Young  
Secretary-Treasurer  
The Penfield Company of California  
1427 South Robertson Boulevard  
Los Angeles, California

Re: Securities and Exchange Commission v. The  
Penfield Company of California, Civil Action  
No. 2863 in the District Court of the United  
States for the Southern District of California,  
Central Division.

Dear Sir:

As doubtless you have been advised, the mandate of the Circuit Court of Appeals for the Ninth Circuit, affirming the judgment of the District Court in the above-entitled matter, was filed and entered upon the records of the District Court on December 7, 1944.

The undersigned, by and under the direction of the Securities and Exchange Commission, will call at the office of the Penfield Company at 10:00 o'clock on the morning of Wednesday, January 24, 1945, for the purpose of examining those books and records referred to in the Order of Judge Peirson M. Hall, dated June 1, 1943, which constituted the

judgment above referred to. A copy of Judge Hall's Order is inclosed.

Yours very truly,

(Signed)            CHARLES R. BURR,  
Assistant Regional Adminis-  
trator. [8]

ccs: A. W. Young  
683 Kelton Avenue  
West Los Angeles, California

Morris Lavine, Esq.  
620 Bartlett Building  
Los Angeles, California

Francis A. Reilly, Esq.  
6233 Hollywood Boulevard  
Hollywood 28, California

Flanagan, Wilson & Thomas  
Attention Philip L. Wilson, Jr.  
453 South Spring Street  
Los Angeles, California [9]

EXHIBIT B (ENCLOSURE)

Copy

Edward H. Cashion, Counsel; John F. Davis, Solicitor; C. J. Odenweller, Jr., Regional Administrator; James M. Evans, Attorney, Attorneys for Applicant, Securities and Exchange Commission, Room 1737, United States Post Office and Courthouse, Los Angeles, California.

In the District Court of the United States for the  
Southern District of California, Central Di-  
vision

Civil Action No. 2863-P.H.—Civ.

SECURITIES AND EXCHANGE COMMIS-  
SION,

Applicant,

vs.

THE PENFIELD COMPANY OF CALIFOR-  
NIA, a California Corporation,

Respondent.

### ORDER

This Cause came on to be heard on return of a rule to Show Cause why the Respondent should not be required to comply with a subpoena duces tecum, a copy of which is attached to the Application herein as Exhibit C.

Upon the pleadings, the evidence, and the statement and briefs of counsel for the parties herein, the Court finds that the Applicant has made sufficient and reasonable showing entitling it to have its subpoena duces tecum enforced and to have produced, pursuant thereto, the books, records and documents hereinafter set forth, which are germane to the subject matter of the investigation instituted by the Applicant pursuant to Section 19(b) of the Securities Act of 1933, (15 U.S.C. §77s(b)) and which are material and relevant to such inquiry.

It Is Therefore Ordered that A. W. Young, Secretary-Treasurer of The Penfield Company of California, appear before C. J. Odenweller, Jr., an officer of Securities and Exchange Commission, or such other person or persons as may be designated by Securities and Exchange Commission, on the 8th day of June, 1943, and at any adjournments thereof as determined by said officer or employee of Securities and Exchange Commission, at Room 1737 of the United States Post Office and Courthouse, Los Angeles, California, and to produce the following books, papers and documents of The Penfield Company of California and relating to the business carried on and conducted by the said The Penfield Company of California:

1. Minute Book
2. All stock certificate stub books and cancelled certificates of common and preferred stock.
3. Alphabetical list of stockholders and addresses (if not shown on stub books indicated in Item No. 2 above.)
4. General ledger.
5. Cash book.
6. General journal.
7. Records reflecting the sale of whiskey and/or whiskey warehouse receipts by the corporation. [11]
8. Records relating to the sale of bottling contracts of Bourbon Sales Corporation, Louisville, Kentucky, by the corporation.

9. Records relating to the sale of bottling contracts of The Penfield Company of California, by the corporation.

10. Correspondence files, including letters received from and copies of letters sent to, all stockholders of The Penfield Company of California.

11. Correspondence files containing letters received from, and copies of letters sent to, all persons to whom bottling contracts of Bourbon Sales Corporation or The Penfield Company of California were sold.

12. All cancelled checks of the Corporation.

13. Copies of confirmation or advices delivered in connection with the sale of stock of The Penfield Company of California or the sale of bottling contracts of Bourbon Sales Corporation, or The Penfield Company of California.

14. All original journal entries or journal vouchers supporting entries appearing in the general journal or cash books.

15. Copies of all prospectuses, sales material, sales letters, material in salesman's kits or similar documents used in connection with the solicitation and sale of stock in The Penfield Company of California.

16. Copies of all prospectuses, sales material, sales letters, material in salesmen's kits or similar documents used in connection with the sale of bottling contracts of Bourbon Sales Corporation of The Penfield Company of California.

17. Purchase invoices or records supporting the acquisition of whiskey, whiskey warehouse receipts or bottling contracts by The Penfield Company of California from private individuals for cash or in exchange for stock, bottling contracts or other securities. [12]

18. Purchase invoices or other records supporting the acquisition of whiskey or whiskey warehouse receipts from distillers, whiskey warehouse receipts brokers or other persons or companies engaged in the whiskey business.

19. Sales invoices or records supporting the disposition of whiskey, whiskey warehouse receipts or bottling contracts procured from investors.

20. Employment or other records showing names of all employees, of salesmen or other personnel with last known addresses.

It Is Further Ordered, that in accordance with the stipulation and agreement of the parties made in open court, that the books, papers and documents herein ordered to be produced, as aforesaid, in lieu of their physical production, as heretofore ordered, shall be made available to such officer and employees of Securities and Exchange Commission as may be designated, at the office of Respondent, at 8900 Beverly Boulevard, Los Angeles, California.

Jurisdiction of the Cause is written for the purpose of giving full effect to this Order and for the purpose of making such other and future Orders and Decrees, or taking such other action, if any, as



may become necessary or appropriate to carry out and enforce this Order.

Dated: June 1st, 1943.

PEIRSON M. HALL,  
United States District Judge.

Approved as to form.

FRANCIS A. REILLY,  
Attorney for Respondent.

[Endorsed]: Filed Jan. 24, 1945. [13]

————

[Title of District Court and Cause.]

### ORDER

Upon reading and considering the verified "Affidavit for order to Adjudge A. W. Young, Secretary-Treasurer of the Penfield Company of California, in Contempt," this day filed in the above entitled action, and good cause being shown thereby;

It Is Ordered that A. W. Young, Secretary-Treasurer of the Penfield Company, appear before the undersigned Judge of the above entitled Court, in the United States Courthouse in the City of Los Angeles, California, on the 5th day of February, 1945, at 2:00 o'clock, P.M. of that day, or as soon thereafter as the matter may be heard, and show cause, if any there be, why a further order should not be made herein, ordering and directing said A. W. Young, Secretary-Treasurer of the Penfield Company to show cause why an order should not

be made holding said A. W. Young in contempt of this Court and to be dealt with accordingly.

Dated: January 23, 1945.

PEIRSON M. HALL,  
United States District Judge.

### AFFIDAVIT OF SERVICE BY MAIL

State of California,  
County of Los Angeles—ss.

Doris Dillon Carlton, being first duly sworn, says: That affiant is a citizen of the United States and a resident of the County of Los Angeles; that affiant is over the age of eighteen years and is not a party to the within and above entitled action; that affiant's business address is 1737 U. S. Post Office and Courthouse, Los Angeles, California. That on the 24th day of January, A. D. 1945, affiant served the within Order in said action, by placing a true copy thereof in an envelope addressed to Morris Lavine, the attorney of record for said Respondent in the Ninth Circuit Court of Appeal and Flanagan, Wilson & Thomas, the attorneys of record for said Respondent in this Court, at the business addresses of said attorneys, as follows: Morris Lavine, Esquire, 620 Bartlett Building, Los Angeles, California, and Flanagan, Wilson & Thomas, Attention Philip L. Wilson, Jr., 453 South Spring Street, Los Angeles, California, and by then sealing said envelope and depositing same, with postage thereon fully prepaid, in the United States Mail at Los Angeles,

California, where is located the offices of the attorneys for the persons by and for whom said service was made. That there is delivery service by United States mail at the place so addressed and there is a regular communication by mail between the place of mailing and the place so addressed.

DORIS DILLON CARLTON.

Subscribed and sworn to before me this 24th day of January, 1945.

[Seal]                      G. M. CUTHBERTSON,  
Notary Public.

[Endorsed]:    Filed Jan. 24, 1945. [15]

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[Title of District Court and Cause.]

### ORDER

Upon reading and considering the verified "Affidavit for Order to Adjudge A. W. Young, Secretary-Treasurer of the Penfield Company of California, in Contempt," filed in the above entitled cause on January 24, 1945, and further upon consideration of the oral arguments this day made in open court on the order issued by this Court on January 24, 1945, directing A. W. Young, Secretary-Treasurer of the Penfield Company, to show cause why a further order should not be made directing him to show cause why an order should not

be made holding him in contempt of this Court, and good cause appearing therefor;

It Is Ordered that A. W. Young, Secretary-Treasurer of the Penfield Company, appear before the undersigned Judge of the above entitled court in the United States Courthouse in the City of Los Angeles, California, on the 26th day of February, 1945, at 10:00 o'clock a.m. of that day, or as soon thereafter as the matter may be heard, and show cause, if any there be, why an order should not be made holding said A. W. Young, Secretary-Treasurer of the Penfield Company, in contempt of this Court, and to be dealt with accordingly. [16]

It Is Further Ordered that this order and all supporting affidavits shall be served upon the said A. W. Young, Secretary-Treasurer of the Penfield Company of California, by the United States Marshal or one of his deputies.

Dated: February 8, 1945.

PEIRSON M. HALL,

United States District Judge.

Approved as to form.

MORRIS LAVINE,

By FULTON B. SAFIN,

Attorney for Respondent.

[Endorsed]: Filed Feb. 8, 1945. [17]

At a stated term, to-wit: The February Term, A. D. 1945, of the District Court of America, within and for the Central Division of the Southern District of California, held at the Court Room thereof, in the City of Los Angeles, on Monday, the 2nd day of July, in the year of our Lord one thousand nine hundred and forty-five.

Present: The Honorable Peirson M. Hall, District Judge.

[Title of Cause.]

This cause coming on for hearing on Order to Show Cause why A. W. Young, Secretary-Treasurer of the Penfield Company of California, should not be held in contempt of Court and dealt with accordingly, pursuant to order filed February 8, 1945; G. Morgan Cuthbertson, Esq., appearing as counsel for the plaintiff; Morris Lavine, Esq., appearing as counsel for the defendant:

Each of the said counsel makes a statement. Defendant Young is now found guilty of contempt of the Order to Produce Books and Records of the defendant company and it is the judgment of the Court that Defendant Young pay a fine of \$50 and stand committed until paid, following which, on motion of Attorney Lavine, the defendant is allowed until 10 A.M., July 3, 1945, to pay the said fine. [18]

[Title of District Court and Cause.]

### NOTICE OF APPEAL

Notice is hereby given that the Securities and Exchange Commission, the applicant above named, hereby appeals to the Circuit Court of Appeals for the Ninth Circuit from the judgment and order of this Court, entered July 2, 1945, which fined A. W. Young, secretary-treasurer of the respondent, \$50 for contempt and ordered him to stand committed until the fine was paid.

Dated: September 24, 1945.

ROGER S. FOSTER,  
Solicitor.

HOWARD A. JUDY,  
Regional Administrator.

G. MORGAN CUTHBERTSON,  
Attorneys for Securities and  
Exchange Commission.

[Endorsed]: Filed Sept. 26, 1945. [19]

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[Title of District Court and Cause.]

### STATEMENT OF POINTS

This proceeding is one for civil contempt against A. W. Young, secretary-treasurer of the respondent, for disobedience of the order of this Court dated June 1, 1943, affirmed by the Circuit Court of Appeals, directing Young to produce specified

books and records of the respondent for examination by the appellant, pursuant to Section 22(b) of the Securities Act of 1933 (15 U.S.C. §77v(b)).

In its appeal, the appellant intends to rely upon the point that the District Court, having adjudged Young to be in contempt, erred in ordering Young to pay a fine of \$50 and stand committed until the fine was paid, instead of imposing a remedial penalty, calculated to coerce Young to produce or allow inspection of the books and records of the respondent pursuant to the said order of June 1, 1943.

Dated: October 2, 1945.

ROGER S. FOSTER,  
Solicitor.

HOWARD A. JUDY,  
Regional Administrator. [20]

G. M. CUTHBERTSON,  
Attorneys for Securities and  
Exchange Commission. [21]

Received copy of within "Statement of Points"  
this 3 day of October, 1945.

MORRIS LAVINE.

By M. B. SAFIN,  
Attorney for Respondent.

[Endorsed]: Filed Oct. 4, 1945. [22]

[Title of District Court and Cause.]

## DESIGNATION OF CONTENTS OF RECORD ON APPEAL

The Securities and Exchange Commission, appellant herein, designates as the record on appeal the following portions of the record, proceedings and evidence in the civil contempt proceeding against A. W. Young, secretary-treasurer of the respondent:

1. Affidavit of Charles R. Burr of the Securities and Exchange Commission, filed January 24, 1945, in support of rule to show cause why A. W. Young, secretary-treasurer, Penfield Company of California, should not be adjudged in contempt, together with exhibits thereto as follows:

Exhibit A—Supplemental order of the Securities and Exchange Commission, dated January 16, 1945, directing investigation and designating officers to take testimony.

Exhibit B—Letter of Charles R. Burr to A. W. Young, dated January 16, 1945, and Order of Judge Peirson M. Hall, dated June 1, 1943.

2. Order of Judge Peirson M. Hall, dated January 23, 1945.

3. Transcript of proceedings before Judge Peirson M. Hall on February 8, 1945.

4. Order of Judge Peirson M. Hall, dated February 8, 1945. [23]



5. Transcript of proceedings before Judge Peirson M. Hall on July 2, 1945.

6. Judgment and order, entered July 2, 1945.

7. Notice of appeal filed September 26, 1945.

8. Statement of points.

9. This designation.

Dated: October 2, 1945.

ROGER S. FOSTER,  
Solicitor.

HOWARD A. JUDY,  
Regional Administrator.

G. M. CUTHBERTSON,  
Attorneys for Securities and  
Exchange Commission. [24]

Received copy of within "Designation of Contents of Record on Appeal" this 3 day of October, 1945.

MORRIS LAVINE.

By M. B. SAFIN,  
Attorney for Respondent.

[Endorsed]: Filed Oct. 4, 1945. [25]

[Title of District Court and Cause.]

### CERTIFICATE OF CLERK

I, Edmund L. Smith, Clerk of the District Court of the United States for the Southern District of California, do hereby certify that the foregoing pages numbered from 1 to 25, inclusive, contain full, true and correct copies of Affidavit In Support of Rule to Show Cause Why A. W. Young, Secretary-Treasurer, Penfield Company of California, Should Not Be Adjudged in Contempt with exhibits thereto; Order dated January 23, 1945; Order dated February 8, 1945; Minute Order Entered July 8, 1945; Notice of Appeal; Statement of Points and Designation of Record on Appeal which, together with copy of Reporter's Transcripts dated February 8, 1945, and July 2, 1945, transmitted herewith, constitute the record on appeal to the United States Circuit Court of Appeals for the Ninth Circuit.

Witness my hand and the seal of said District Court this 1st day of November, 1945.

[Seal]      EDMUND L. SMITH,  
                                 Clerk.

By THEODORE HOCKE,  
                                 Chief Deputy Clerk.

In the District Court of the United States in and  
for the Southern District of California, Central  
Division

Before the Honorable Peirson M. Hall.

No. 2863-PH—Civil

SECURITIES & EXCHANGE COMMISSION,  
Plaintiff,

vs.

PENFIELD COMPANY OF CALIFORNIA, and  
A. W. YOUNG, Secretary-Treasurer,  
Defendants.

REPORTER'S TRANSCRIPT OF  
PROCEEDINGS

Los Angeles, California

February 8, 1945

Appearances:

For the Plaintiff: J. Leonard Townsend, Assistant Solicitor, Securities and Exchange Commission; and Charles H. Carr, United States Attorney; by Homer H. Bell, Assistant United States Attorney.

For the Defendants: Morris Lavine, 619 Bartlett Bldg., Los Angeles, California, and William J. Clark, 619 South Olive Street, Los Angeles, California. [1\*]

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\*Page numbering appearing at top of page of original Reporter's Transcript.

Los Angeles, California,

Thursday, February 8, 1945, 10 A. M.

The Court: Very well. Call the calendar.

The Clerk: 2863. Securities and Exchange Commission vs. Penfield Company of California. Hearing on order to show cause why A. W. Young, Secretary-Treasurer of the Penfield Company, should not be held in contempt of court and dealt with accordingly.

The Court: Let me see the files.

(Court examines file.) Ready in that matter?

Mr. Lavine: Yes, your Honor.

The Court: All right. And the other matter?

The Clerk: 17230. United States of America vs. the Penfield Company of California, and others. Hearings on the motion of defendant Alfred W. Young to quash subpoena duces tecum.

The Court: Ready in that matter?

Mr. Bell: Yes.

(The court at this time heard Case No. 17230, United States vs. The Penfield Company of California.)

The Court: Very well. The other matter on the calendar is the same matter under a different title.

Mr. Townsend: Do I understand, your Honor, Mr. Lavine has already expressed the position of the defendants?

The Court: I understood that he had not.

Mr. Townsend: Well, then, your Honor,— [2]

The Court: At the conclusion of his remarks a

few moments ago he said that he had not. I understood him to indicate that he desired to have something further to say.

Mr. Townsend: I see.

The Court: Inasmuch as you are the moving party, I think it is your first shot at it.

Mr. Townsend: I think under these circumstances, your Honor, my statement is just to call your Honor's attention to the affidavit and the rule you issued——

The Court: Very well.

Mr. Townsend: And there being no other evidence in the matter, unless some showing as to why the rule should not issue.

Mr. Lavine: I will answer that, your Honor, that on examination it appears, as your Honor will see, there was no personal service of the rule, or of change of date, and all they did was to mail out copies of this to various parties, and some order of this last proceeding they had commenced, and under Rule 54 of the Rules of Civil Procedure for the District Courts of the United States process must be served by the United States Marshal, or his deputy, or by some person especially appointed by the court for that purpose, except a subpoena may be served as in Rule 45.

Now, of course, this is a subpoena duces tecum and I think all parties were entitled to a subpoena.

The Court: Is this a subpoena duces tecum? [3]

Mr. Lavine: No, this is a rule to show cause. No, this is not a subpoena duces tecum; originally

it was, and then it has gotten now into an order to show cause. I will submit the matter.

Mr. Townsend: I understand, do I, that is the full showing that counsel is making in response to the rule this morning?

Mr. Lavine: Yes, that is the complete issue. There is the proceeding here at this time to require us to show cause why we should not be cited for contempt; that, and the fact that the same proceeding was had by the Grand Jury requiring some documents, and it was for the purpose of an investigation, and since that time there has been returned a new indictment, all of this before your Honor, and which your Honor can take judicial notice of.

The Court: Rule 54? In other words, you maintain this is a process?

Mr. Lavine: Yes.

The Court: That the order is a process?

Mr. Lavine: Yes, this last order is a process.

The Court: That is the order of this court dated June 1, 1943?

Mr. Lavine: No, that is not a process, your Honor. I do not maintain that.

The Court: That is the order which directed the Penfield Company to produce its books and records and make [4] them available.

Mr. Lavine: That is right, as of a certain date, your Honor.

The Court: From which an appeal was taken?

Mr. Lavine: From which an appeal was taken.

The Court: Now, let me see.

Mr. Lavine: And then your Honor stayed the order pending the appeal. Your Honor granted the stay and bond was put up and there was a stay granted. That was on entire appeal. Now, they come back here and certainly that order cannot be complied with as of that date and of that time.

The Court: Then there is the change in adjournment thereof as determined by said officer or employee of the Securities and Exchange Commission. Now, I stayed the order, and I stayed it pending the determination on appeal.

Mr. Lavine: The mandate on appeal was filed December 7, 1944. The affidavit in support of the rule to show cause shows that on January 16, 1945, the order of investigation of the Commission was further amended by the designation of Mr. Burr, the affiant. Does it show who designated him in this?

Mr. Townsend: Designated whom, and for what, your Honor?

The Court: For disclosure of the information desired.

Mr. Townsend: And you will find attached to the affidavit, your Honor, a letter over Mr. Burr's signature addressed to the company, specifically to Mr. Young, in [5] which Mr. Burr informed the company that he would present himself at the office of the company——

The Court: On January 24, 1945.

Mr. Townsend: That is right. Yes, your Honor. And access to the books was refused.

The Court: Let me see, Mr. Lavine, let me fol-

low you further. Your contention is not, therefore, that the affidavit of June 1, 1945, nor the letter making the continuance, is a process? Your contention is not that they are a process?

Mr. Lavine: No.

The Court: You do not contend they are a process?

Mr. Lavine: No.

The Court: Now, what do you contend is the process which was required to be served by the marshal, the order to show cause?

Mr. Lavine: Yes, the order to show cause and the order of Mr. Burr, or some officer of the Commission, which he merely stated by means of a letter.

The Court: Which order of Mr. Burr? The letter just referred to?

Mr. Lavine: Of January 16, 1945.

The Court: I do not believe that that could be considered a process. There was the order of June 1, 1943, fixing the date of the 8th of June, 1943, and any adjournment thereof as determined by said officer or employee to [6] produce the full books and papers and records. As I indicated, I stayed that order pending appeal, and until after the mandate was signed this order could not be effective; after the mandate was signed, of course, June 8, 1943, had long since expired, and under the terms of this there would have to be another date either fixed by virtue of an adjournment, so-called, or a fixed inquiry, because otherwise the order of the court could be completely thwarted by merely taking an appeal. That day went by. Consequently, this



date of this letter of January 16, 1945, it seems to me could not, under any circumstances be held to be a process. It is merely a notice of the date of the adjournment of the original day of June 8, 1943. So I will hold against you on that point.

Now, what is your other point as to what is process? That the order to show cause here is process?

Mr. Lavine: Yes, your Honor. This is a proceeding in contempt, your Honor.

The Court: This is not yet a proceeding in contempt.

Mr. Lavine: No, just for an order to show cause.

The Court: I suggest to Mr. Townsend that in matters such as these, I consider it better practice, in civil matters, to make a motion for a rule to show cause why an order to show cause for contempt should not be granted. If you will observe, the order as originally presented was changed so that, in fact, now it is nothing more than a [7] motion for a rule to show cause. As this order reads, he appeared before the court on this date, which was the 5th, and it was continued to the 8th, to show cause, if any there be, why a further order should not be made on A. W. Young holding the said Young in contempt of this court. Nowhere is it stated it is in the nature of a motion for a rule to show cause, which, in my opinion, is the better practice, so I do not and I cannot hold with you that this is a process. If the order to show cause for contempt issues as a result of this motion, that, in my judgment, would be a process

and would be required to be served by the marshal, as it would be the institution of criminal proceeding.

Mr. Lavine: That is my misunderstanding of the nature of the proceeding, as I saw the original papers and did not see what I thought was the original order, or original motion.

The Court: All right. And now, if I hold against you on that point, what other point have you to make?

Mr. Lavine: I have this to say, your Honor, in respect to that matter. The case of Walling vs. United States, which was decided by this Circuit, holds an investigation by the Securities and Exchange Commission is similar in effect and purpose to that of a grand jury investigation. The Securities and Exchange Commission commenced this investigation and then apparently turned the matter over to the United States District Attorney. I think, for the purpose [8] of securing the identical documents, papers, and so forth, which the records before your Honor show were sought by the Grand Jury. Now, they have had the return of the indictment based upon the showing which was made before the Grand Jury and in which it was claimed these papers and documents were sought to be had. And then, before the Circuit Court the appellant, in opposition, requested for time to petition for a writ of certiorari, and the Securities and Exchange Commission set forth it was for the purpose of having an indictment returned, as I recall it, or for the purpose of concluding their investigation be-

fore October 5, 1944, that the particular books, papers, records or documents were sought. They are the ones that have been sought, the identical ones, that have been sought, in all of these proceedings. They are general, and include all the records, books, and papers, and there can be no purpose now in the Securities and Exchange Commission seeking them, other than to secure evidence for the trial in the identical case in which they were sought. And I submit under those circumstances that they should not be permitted now to conduct an investigation that has been concluded by the return of the indictment, under which all of these defendants are now under indictment. That is all, your Honor, I have to say.

Mr. Townsend: May it please the court, because this is perhaps the only chance I will have—— [9]

The Court: You have been admitted specially to appear in this case, or are you a member of the Bar here?

Mr. Townsend: I am not a member of the Bar here, and I have never appeared or had any motion to be admitted in any District Court here before, but if your Honor wishes that——

The Court: Well, I think perhaps to avoid any possible question in that connection, I will entertain a motion, Mr. Bell.

Mr. Lavine: I will raise no objections, your Honor.

The Court: I think the record had better be straight.

Mr. Bell: Your Honor, I move the admission of

Mr. Leonard Townsend for the special purpose of handling this matter which is now pending before your Honor.

The Court: Mr. Townsend is a member of the Bar of what state?

Mr. Townsend: The District of Columbia, your Honor, Maryland, and a member of the Bar of the Supreme Court.

The Court: Very well, Mr. Townsend is admitted specially for the purposes of this case, or this order, or this hearing.

Mr. Townsend: I think this hearing.

The Court: This hearing.

Mr. Townsend: Yes.

The Court: All right. You may proceed.

Mr. Townsend: Inasmuch as this is probably the only [10] time I shall be before your Honor on this matter regardless of the outcome of the present proceedings, and as it was intended that I should have been associated in this matter until completion, I felt that perhaps a more extended set of remarks might be in order, and I ask your indulgence for that purpose.

I am particularly impelled to do so by virtue of two things your Honor has said this morning, the first of which is that the proceeding that the Securities and Exchange Commission has instituted here looks towards a criminal proceeding.

The Court: I don't know that I said that, but if I did it is obvious that it does.

Mr. Townsend: I am going to address myself to that in particular, may it please your Honor.

The Court: All right.

Mr. Townsend: The second proposition your Honor just enunciated was, that a rule to show cause in a proceeding that we are appearing in would be in the nature of a process and required to be served. I shall respectfully attempt to dissuade your Honor from both those points of view, and I think that can be done very shortly.

Let it be said at the outset that what we are after here is the enforcement of your Honor's order entered almost two years ago and still unobeyed, notwithstanding the fact, your Honor, that it has been successfully affirmed [11] at every step and every level of the federal judiciary. That case was very clear, may it please the court, that in a proceeding brought to enforce a court's order where the object sought is to compel compliance, there would be no question at all but that the proceeding to that end is purely remedial and, therefore, civil in nature.

There are three cases that have arisen in this jurisdiction which are leading cases all over the country on that subject, your Honor. They are the case of *McCrone vs. United States*; still another, *Clarke vs. Federal Trade Commission*; and a recent case, *Fenton vs. Walling*; all of which I am sure your Honor has read.

The Court: I don't remember them. Don't take anything for granted when you are arguing with me.

Mr. Townsend: I am proposing to go into it completely.

The Court: All right.

Mr. Townsend: In the McCrone case, which was affirmed by the Supreme Court——

The Court: What is the citation of the McCrone case?

Mr. Townsend: That is 307 U.S., at page 61; and it is in the Ninth Circuit Court of Appeals at 100 Fed. (2d), page 322. Now, in that case, your Honor,——

The Court: Let's get them in here. The bailiff will bring them in.

Mr. Townsend: All right. There are lots of them on this subject. [12]

The Court: The second one that you mentioned is?

Mr. Townsend: Clarke vs. Federal Trade Commission.

The Court: Clarke?

Mr. Townsend: Clarke. 128 Fed. (2) at 542.

The Court: And the third one?

Mr. Townsend: Fenton vs. Walling. Just a moment, your Honor. That is in 139 Fed. (2d) at 608. Certiorari was denied in 321 U.S.

The Court: Will you get me 307 U.S., 128 Fed. (2d) and 139 Fed. (2d)?

Mr. Townsend: In this case, your Honor, the Circuit Court of Appeals in this Circuit, and the Supreme Court of the United States said, in substance, this: There should be no difficulty in distinguishing between so-called civil and so-called criminal contempts. And the test is a simple one. If what is sought in the one instance is for the bene-

fit of one of the parties to the action, and is for that purpose alone, it is a civil contempt; if there be any such purpose, or if it partake of that purpose, and yet be for the purpose of presenting contumely before the courts, and is particularly in the public interest to see that that should not happen, then it is a criminal case and instituted through criminal proceedings.

The Court: The Securities and Exchange Commission does not operate for itself, does it? I mean it operates in the public interest, doesn't it? [13]

Mr. Townsend: It does, indeed, your Honor. Now, in this case we are most emphatically urging upon your Honor that our purpose in being here is to enforce your order and nothing else. In this type of case, the proceedings, as the courts have said time and time again, result in a commitment of a party, and that party carries with him into the jail house the keys to that jail, meaning thereby that when he chooses to obey the court's order he can open the doors and walk out a free man.

The Court: If those are the terms of the order.

Mr. Townsend: Assuming that is the usual form in the case. We have here the usual form in each of the cases I am now about to speak of.

Now, let's consider the McCrone case, your Honor. There an Internal Revenue investigation was under way, a subpoena was directed to a person to appear to testify, but the person refused to testify; application was made to the District Court, and the District Court entered an order as your Honor did in this case, directing the person to

appear and testify. He continued to refuse. A rule to show cause was issued why he should not be adjudged in contempt. He was adjudged in contempt and committed until he should purge himself. The Circuit Court of Appeals for the Ninth Circuit affirmed; so did the Supreme Court. The Supreme Court said this, your Honor, among other things:

“While particular acts do not always lend [14] themselves to classification as civil or criminal contempts, a contempt is considered civil when the punishment is wholly remedial, serves only the purposes of the complainant, and is not intended as a deterrant to offenses against the public.”

Now, that quotation is one of the most familiar ones in the law on contempt, your Honor, because it is particularly a paraphrase, as some of them are, of the decision of the United States Supreme Court in the case of *Gompers vs. Bucks Stove & Range Company*, 221 U.S. 418, and I would like to read, your Honor, what the Supreme Court has said in discussing the matter in that case. It said this:

“\* \* \* It is true that punishment by imprisonment may be remedial as well as punitive and many civil contempt proceedings have resulted not only in the imposition of a fine, payable to the complainant, but also in committing the defendant to prison. But imprisonment for civil contempt is ordered where the defendant has refused to do an affirmative act required by the provisions of an order which, either in form or substance, was mandatory in its character. Imprisonment in such cases is not inflicted as a punishment, but is in-



tended to be remedial by coercing the defendant to do what he had refused to do. The decree in such cases [15] is that the defendant stand committed unless and until he performs the affirmative act required by the court's order."

Now, in the Clarke case, your Honor, we have a different agency, the Federal Trade Commission, and the same pattern was before one of the judges of this district; as I remember it, Judge Harrison. There was a subpoena by the agency; a refusal to testify; an order of the court directing testimony; refusal to obey the order; a rule to show cause; a commitment for contempt; and a sustaining of the case in the Ninth Circuit Court of Appeals on the ground that the only question in the case is, has the order been obeyed.

The Fenton case is another subpoena case. It was a case in which the court exercised its powers under the discovery provisions of the new Rules of Civil Procedure; discovery was ordered; subpoena issued, and subpoena disobeyed; the court found after a rule to show cause that the complainant was entitled to an order of contempt until the disobeying person had complied with the order and had purged his conduct.

So let there be no mistake of what our position is, that this is a civil proceeding, a civil one, and if the time should arrive when this court orders its original order to be enforced by a committing order, it is still in nature, and never gets to the stage of a criminal proceeding in this particular instance.

Now, the second proposition I want to address myself to is the question of whether a rule to show cause for civil contempt is process and required by its terms to be served personally upon the defendant, and in connection therewith let me call your Honor's attention to the cases which have already decided that question.

In *National Labor Relations Board vs. Hopwood Retinning Company*, and that is to be found in 104 Fed. (2d), page 302, decided by the Second District Court of Appeals, the Second Circuit was called upon to enforce an order of enforcement which it had theretofore granted at the behest of the National Labor Relations Board. In the course of the proceedings holding the respondents in contempt, the Circuit Court of Appeals said this:

"As a proceeding for civil contempt, this is therefore properly a continuance of the earlier action in this court, and is a step in the enforcement of our previous judgment. Hence it was correctly instituted by motion served upon the counsel appearing for the parties in the record."

I can cite your Honor to another District Court case in the District of Columbia, which happens to be my bailiwick.

The Court: Well, that is reasonable authority.

Mr. Townsend: Thank you, your Honor, on behalf of the judges there. In that jurisdiction, your Honor, we have—— [17]

The Court: What is the citation?

Mr. Townsend: I will have to get it. It is right

here. *Tilgham vs. Tilgham*, contained in 47 Fed. Supp. at page 417.

The Court: 57?

Mr. Townsend: Fed. Supp., at 417.

The Court: That is the current one, is it?

Mr. Townsend: Yes, your Honor.

The Court: What kind of a case was it? It sounds like a divorce case.

Mr. Townsend: I was about to say to your Honor, that in our jurisdiction, in Washington, they exercise general jurisdiction over local matters. In this case the show cause order for contempt had been entered and it had been disobeyed. The rule in our jurisdiction is that in such cases service on non-residents may be had by publication and the order for a rule to show cause was served by a Deputy United States Marshal on the man in an entirely different jurisdiction. Judge Pine in that case held that such a proceeding was wholly remedial in aid of this order, held it was civil in nature and would not have to be served under the new rule of notice to counsel.

The Court: In any event, the rule is different in California.

Mr. Townsend: In the Federal Court?

The Court: In the California courts, in the State [18] courts.

Mr. Townsend: Now, I want to get back to the main track, so to speak.

The Court: Well, you can still have process in a civil action, can you not?

Mr. Townsend: I would suppose this, your Honor,——

The Court: Is the original summons a process?

Mr. Townsend: Yes, the original summons is a process. It must be served. There is no question about that.

The Court: Is there anything else in a civil action that is process?

Mr. Townsend: I don't know of anything your Honor.

The Court: Why should the rule say that service of all process shall be made by the Marshal or his Deputy except that a subpoena may be served as in Rule 45? Now, it indicates the subpoena is process, and it certainly is process if it is a requirement by the court.

Mr. Townsend: I don't read the rules in the same way. As a matter of fact, your Honor will remember when I presented the preliminary rule before you it was my position that, being a preliminary step of a rule to show cause as to why a rule to show cause should issue in a case was probably not, in our judgment, consonant with the new rules.

The Court: I understand.

Mr. Townsend: It is our position a simple motion [19] under the new rules to adjudge in contempt is the appropriate proceeding today, and could be set down even under the five-day rule, but we desired counsel to have adequate opportunity, and hence we followed the longer period and used the other proceeding. Now, getting to the merits of this thing, your Honor——

The Court: Pardon me. Let me ask you another question, at this point.

Mr. Townsend: Yes, your Honor.

The Court: Assuming the rule to show cause was issued and trial was had and the defendant was found in contempt, would the Court have any power to punish him, say, fine him and put him in jail for disobedience of the order?

Mr. Townsend: In a civil proceeding I think your Honor has the power to punish him, without doubt; you can punish him by fine or by imprisonment, and I have some cases I think your Honor will find interesting on the question that you have no discretion to deny it if the order issued or if the showing it made that the order has not been obeyed.

The Court: In other words, in the event I find the failure to comply, that the court is compelled arbitrarily to require him to comply?

Mr. Townsend: I think that is the substance of the opinions, your Honor.

There has been much attempt by Mr. Lavine, and I [20] think by Mr. Clark, to inject into these proceedings what may be called an argument touching the equities of the situation. I think it hardly falls with any grace from their lips to urge that upon this Court. Certainly there is no timely ground for failing to obey an order almost two years old, and certainly no legal one that I have heard any authority about. It would seem to indicate that a complete and apparently bland disregard of this Court's order. But, however that may be, I suppose the Supreme Court has many times, as your

Honor knows, said that the civil rights of citizens under the Constitution come first and so long as they may properly involve his civil rights it is better perhaps, that some person should escape the penalty of the law, than that the Constitution should be thwarted in its benevolent purpose. And so I say properly, and perhaps justifiably in my own mind, we have had the successive levels of this appeal, even though it has been pointed out, your Honor, that every one of the propositions that have been urged in the Appellate Court had been already decided, as was pointed out in the opinion and had been set at rest in previous actions of the Court. However, as I say, perhaps this presumption is to be indulged under the circumstances and may be they were seeking the right of review and not intending to delay a lawful investigation. But it seems to me, your Honor, that when once the parties have exhausted those rights that are guaranteed them under our [21] system of government and have, beyond that point, undertaken blandly to disobey your order, that then that clears everything that has preceded it, and it ought, by all the rules it seems to us, to call for the strong right arm of this Court, and to use, if I may so express it, the sword of Damocles to put an end to these pious judicial utterances. We didn't come into this court——

The Court: Which pious judicial utterances do you refer to?

Mr. Townsend: To the ones that there should be no order in this case enforcing your Honor's

order because this has happened, or that has happened, or there has been no rule, or there has been no service.

The Court: You mean the judicial remarks of this Court?

Mr. Townsend: No, your Honor. I mean the remarks of counsel. Your Honor, we did not come before you two years ago in a vain hope. We came in a judicial cause authorized under the law and we got an order from your Honor. It is still the order of this court, and I respectfully submit that your Honor should strictly enforce that order. There are principles and reasons here now which indicate if it is not enforced soon, may it please the Court, this whole purpose may be completely negatived.

Your Honor can see from the original petition which was filed before you nearly two years ago that the order of [22] the Securities & Exchange Commission, under which the enforcement of these proceedings was begun, was commenced in May of 1942. Now, the Statute of Limitations in the Securities Act of 1933 is three years.

The Court: In a criminal proceeding?

Mr. Townsend: Yes, your Honor, in a criminal proceeding.

The Court: And the purpose of the subpoena is, as I remarked, obviously for the purpose of getting information in relation to a possible criminal proceeding?

Mr. Townsend: Possibly, or possibly a civil proceedings, or an administrative proceeding.

The Court: Is there a three year statute on civil proceedings?

Mr. Townsend: There is no statute on that.

The Court: Any statute on administrative proceedings?

Mr. Townsend: No.

The Court: Then the urgency here lies only in connection with a possible criminal proceeding?

Mr. Townsend: That may very well be said to be just the situation, your Honor.

The Court: All right.

Mr. Townsend: As I say, the order of the Commission, under which these proceedings were instituted, began in May of 1942. We have a bare four months in which to develop any facts that the Commission may desire in connection [23] with its regular proceeding, if the provisions of the Act are going to be accorded their full weight. But quite apart from that, your Honor,—

The Court: Let me ask in that connection the Securities & Exchange Commission does not ignore the fact that there is an indictment here, does it?

Mr. Townsend: I don't know what you mean when you say "ignore", your Honor.

The Court: You know what "ignore" means, don't you?

Mr. Townsend: Yes, sir, I do. I don't understand exactly. You see, we did not institute the Grand Jury proceedings.

The Court: Oh, I understand that. But I mean the Securities & Exchange Commission is a part



of the same government for which the United States Attorney acts.

Mr. Townsend: Yes, your Honor.

The Court: Yes. And there is an indictment?

Mr. Townsend: There is.

The Court: A criminal indictment.

Mr. Townsend: There is.

The Court: For violation of the Securities & Exchange Act.

Mr. Townsend: That is right, your Honor.

The Court: All right. Now, what I mean to say is this: the Securities & Exchange Commission is seeking further [24] information or further evidence concerning a possible violation, knowing and generally ignoring that you do have an indictment?

Mr. Townsend: We certainly did know we have an indictment, your Honor;

The Court: In other words, you feel there may be other and further violations by the same defendants?

Mr. Townsend: Yes, that is the purpose of this investigation, your Honor. And possibly other defendants.

The Court: I see.

Mr. Townsend: In other words, we felt at the time that the matter was referred to the Attorney General under our statutory provisions that the investigation as to the matters that we then had evidence concerning could not wait, so that all the evidence we then had we took to the Attorney General.

validating Claims 3 and 4, the defendants in the first case ceased to consider themselves bound by the terms of the consent injunction; whereupon the plaintiff brought a proceeding in contempt of his original case and the lower court having called to its attention the opinion invalidating Claims 3 and 4, refused to commit and an appeal was taken by the plaintiff in the first case. The Second Circuit Court of [27] Appeals, after holding that the consent decree was an estoppel, used this important language:

“While the decree stands they,”—that is, the defendants—“must obey it, and the plaintiff is entitled to the usual sanctions for its enforcement.”

An order of contempt was issued and in the second case damages were awarded the plaintiff for civil contempt to the fullest extent that he would have been entitled to such damages had there been no second suit invalidating these Claims, and such order was affirmed on appeal.

I cite your Honor Judge Woolsey’s opinion in the District Court for the Southern District of New York, in a comparable case, entitled “*In Re Sylvester*” to be found in 41 Fed. (2d), at page 235.

The Court: 245?

Mr. Townsend: 235, 41 Fed. (2d). This language was used, and following it Judge Woolsey cited the *Ingraham* case as his authority.

“In a civil contempt punishment is not discretionary because the object is remedial, and the party invoking the court’s aid on the contempt has the right to its remedy.”

Your Honor, there has been no showing in this case, none at all, on any factual situation, which goes to the question of why the respondent here has not complied with [28] your order. There is not in this record one scintilla of evidence by affidavit or any other form from the mouth of Mr. Young, and he may be here, in answer to your rule, why he has not complied with your Honor's order. There is an affidavit in the record, your Honor, that we have asked him to comply with your order, either the Company or Mr. Young, and they have not done so.

Now, under these circumstances, your Honor, we certainly submit that the strongest possible case should be made out in our favor. But what is urged upon your Honor? It is urged that there has been an indictment. That raises a question that to me, and I think to the courts, and I hope ultimately to your Honor, will be absolutely irrelevant to the question before you, and let me try to convince you that is so. In the case of *Oriel vs. Russell* in the Supreme Court of the United States, your Honor, the proposition was laid down, as to a civil contempt for failure to obey an order of the court, that on the contempt proceeding itself the Court is limited to the reception of only such evidence as goes to the question of the ability or inability of the person who has been commanded by an order to do what the order said. Let me read you the very intelligent language of the Supreme Court on that question.

The Court: Well, that is generally the law, the

event that they might have ability or inability to obey. Of course, that is a very broad term. I have heard hundreds [29] of contempt matters in alimony cases, and that is the general rule. In a few words I would say it is ability or inability. Now, ability or inability might involve a lot of things; it might involve any number of things. It might be a legal inability. In fact, it might be so many things, particularly, things that affect people's lives. But generally that is the rule, the ability or inability to comply with the order.

Mr. Townsend: I want to make sure——

The Court: If there is an intervening right, well, then I think the Court can take that into consideration, too.

Mr. Townsend: Intervening right of what?

The Court: Some order or judgment, or something which affects the situation, which intervenes and affects the rights of the parties. I think the Court can take that into consideration.

Mr. Townsend: I am sorry to say I fail to follow it. It is probably because I am——

The Court: You go ahead with your argument. It is immaterial anyhow.

Mr. Townsend: I am arguing the proposition that the only thing that this court should take into consideration this morning, in answer to this rule, is whether the defendant Young has the books in his possession. I say to your Honor—— [30]

The Court: Not this morning, because when the contempt comes up that will be the time to consider that, if the rule is issued.

Mr. Townsend: All right, your Honor. Yes, when he is called before you for contempt. [31]

The Court: Yes.

Mr. Townsend: I think it is important, your Honor, and I stress and emphasize the point I am trying so hard to make, as to this business about an indictment or any intervening happening, that that has just as much weight, in accordance with the Supreme Court decision which I am about to read from, as if the defendant just said, "I do not want to comply with the order." Now, I may be wrong; but I don't think so.

The Court: That might be true as to corporate books. I would seriously doubt that being true as to any individual's books and papers.

Mr. Townsend: I make that statement recognizing the distinction your Honor is making, yes. This was a turnover of certain books in bankruptcy and the question was has one the right to be supported by clear and convincing evidence, and then the court says, when the lower court decided that the order should be entered it should have before it the kind of clear and convincing evidence that it speaks of, and then it goes on:

"The Referee and the Court in passing on the issue under such a turnover motion should therefore require clear evidence of the justice of such an order before it is made. Being made, it should be given weight in future proceedings as one that may not be collaterally attacked by an effort [32] to try over the issue already heard and decided at the turnover. Thereafter on the motion for com-

mitment the only evidence that can be considered is the evidence of something that has happened since the turnover order was made showing that since that time there has newly arisen an inability on the part of the bankrupt to comply with the turnover order."

The Court: Did Judge Taft write that decision, Mr. Townsend?

Mr. Townsend: Yes, he did, your Honor, yes.

The Court: And doesn't he say along towards the end there that the contempt proceeding there is in the nature of a criminal contempt?

Mr. Townsend: If he does, I don't know how he could possibly say it when he just got through saying the order was coercive in nature, but let us find out. It says:

"A turnover order must be regarded as a real and serious step in the bankruptcy proceedings and should be promptly followed by commitment unless the bankrupt can show a change of situation after the turnover order relieving him from compliance."

He says:

"The proceedings in these two cases have been so long drawn out by efforts on the part of the bankrupts to retry the issues presented on the [33] motion to turn over as to be, of themselves, convincing argument that if the bankruptcy statute is not to be frittered away in countless delays and failures of enforcement of lawful orders, the rule we have laid down is the proper one."

Then here Justice Taft quotes from the Gompers case, which holds it is a civil case, your Honor.

The Court: It is immaterial. My inquiry there was not of any meaning. I remember the case in connection with bankruptcy turnover orders.

Mr. Townsend: Let us suppose we didn't have the case. Let us say we get right down to the question of what Mr. Lavine has presented here as his only argument as to why the rule should not issue. What was it he said? That there was an indictment since the order was entered. Now, I am going to cite your Honor cases right on that very proposition and the first one is one involving the Securities and Exchange Act of 1933, raised in the Circuit Court of Appeals.

The Court: Go ahead.

Mr. Townsend: Your Honor, I should like to cite you the case of *In re Verser-Clay Company*, in 98 Fed. (2d) page 859.

The Court: That is in what book?

Mr. Townsend: 98 Fed. (2d), and certiorari in this [34] case was denied, may it please the court.

The Court: And what is the name?

Mr. Townsend: The title of the case is *In re Verser-Clay Company*.

The Court: On what point do you cite that?

Mr. Townsend: That is on the point that the intervention of an indictment—

The Court: All right.

Mr. Townsend: —is no bar to enforcing your order. There is no need going into the fact because the opinion is very short and states the facts very concisely and they are as follows:

This is by Justice Lewis of the Circuit Court:

“Clay says he relies on the Fifth Article of Amendment to the United States Constitution, U.S.C.A. Const. Amend. 5:

“‘No person \* \* \* shall be compelled in any criminal case to be a witness against himself.’

“He further says that he and Mr. Verser have been indicted in the United States Court for the District of Columbia for criminal offenses described in said Sections 5 and 17 of the Securities Act, and that the object of the Commission and its officers is to obtain from him proof of their guilt and use it against them in that prosecution or use it in finding other indictments, and that the [35] production of the books alone might disclose such incriminating facts and he believes they would. But Clay cannot claim the constitutional privilege for acts of the corporation.”

Citing *Wilson vs. United States*, and citing several other cases; *Wheeler vs. United States*; *Grant vs. United States*; *Brown vs. United States*; *Essgee Company vs. United States*; all Supreme Court cases, as your Honor knows. (Continuing):

“It may be true that there is something in the corporate books and documents that shows personal acts of Clay that tend to incriminate him. If so, he had an opportunity to present them to the District Judge and ask that he be protected in his constitutional rights, but he sought no protection in that respect. It is not claimed that when he was on the witness stand any question was asked the answer to which would tend to incriminate him.



Clearly the privilege asserted by him does not extend to the two corporations.”

Now, your Honor, if that does not dispose of the contention of Mr. Lavine then I am at a loss to know what possibly could, but just on the chance your Honor might wish to consult further the authorities——

The Court: I think the law is very clear about the books and records of a corporation. I think, however, there [36] is still a field of the law where it is just a little unsettled, according to the Supreme Court decisions, about the incrimination of an individual in connection with books and records of a corporation. I am just saying that now more or less from a philosophical viewpoint. I don't know that it is of particular application here, although it might be, because you seek to hold A. W. Young, an individual, in contempt. As indicated by the last remark, there seems to be some field where an individual is entitled to protection. For instance, the Court there says, if he needed protection he should have applied to the District Court for protection.

Mr. Townsend: I have no quarrel with the proposition, your Honor.

The Court: Just how far or just where that goes, I don't know. I was unable to decide as a prosecutor when the question was presented from time to time, and I am still at a little bit of a loss as a Judge as to just where that field begins and ends, but I believe it does exist.

Mr. Townsend: Your Honor, with all due deference, I certainly submit the question, and I think in connection with the matter of compelling an officer of a corporation to produce books of a corporation in the event of a criminal indictment, or otherwise, that matter has been very completely covered.

The Court: Oh, I think that is true, but some place [37] along the line, as they indicate from time to time, and as the Supreme Court recently indicated in the case where they had some labor union officer up——

Mr. Townsend: That is one of the C.I.O. cases?

The Court: In any event, he had charge of the books and records of the corporation and refused to testify, and they held he had to turn over the books of the corporation, but they went on to indicate, not by exact language, but rather by their discussion, that some place along the line there might arise the question of this man's right not to incriminate himself.

Mr. Townsend: The question of whether or not he can be compelled to incriminate himself is not even involved in this proceeding, nor should it be, but assuming for the purposes of the present discussion that it is, certainly the area of that protection, whatever it may be, can extend no further than to his personal and private memoranda, papers and documents, and we do not want his personal, private papers, documents, or memoranda. And your Honor has not issued any such order in this case. On the contrary, we do want, your Honor,

what all the courts have said we are entitled to, the books of the corporation, which, under the law, must be supplied under a proper subpoena.

Now, your Honor, I do intend to draw even more on the authorities in support of the proposition that the intervention of the indictment in these proceedings can have no [38] force or effect upon the matters that are before you in this civil matter. Take the case of Sinclair vs. United States, back in the days when the Senate was investigating the Teapot Dome oil leases. Mr. Sinclair and his corporation were the subject of a grand jury inquiry. They were also the subject of civil suits instituted at the behest of the Attorney General to recover huge sums alleged to be due and owing to the government. While these things were happening, your Honor, the Senate, in investigating it, issued a subpoena to Mr. Sinclair compelling him to testify, or calling for him to testify. He appeared before the Committee and was sworn, and it was then urged upon the Committee that all that this proceeding was intended for was to enable the Government to get some evidence to help it in either or both of its proceedings, criminal and civil in nature. The Committee overruled this objection, asked the question and the witness refused to testify, whereupon he was proceeded against under the applicable statute, and his conviction of the offense was appealed. The Supreme Court, in negating it adopted this rule, if the subpoena is issued in aid of a lawful authority, it cannot be negatived by other considerations; and, therefore, said the

Supreme Court, all we are interested in in this proceeding is, did the Committee and Congress have the authority to have that testimony. It is true, said the Supreme Court, Congress has no authority per se to conduct merely private [39] inquiries in aid of litigation or anything else, so if that was the authority that was asserted, it could not be sustained, but Congress did have the authority, said the Court, to look into the question of these oil situations, look into the obtaining and enactment of legislation in connection therewith, and then the Supreme Court said that the subpoena should have been complied with and that this intervention of different things had no application.

Probably it has happened even in this court, although I am not sure that it has, but it has happened in many district courts, and has been affirmed in many Circuit Courts of Appeal, where we have the analogy of the application of the bankrupt statute, where under one section of the law the trustees are enabled or authorized to proceed to collect funds for the benefit of the estate, and another law gives the trustees the right to subpoena witnesses and to conduct an interrogation into the affairs of the bankrupt. Those cases have uniformly held, your Honor, that the fact that a suit has intervened since the man has been called to give testimony as to those matters, does not change the fact that a suit has intervened since the man has been called to give testimony as to those matters, does not change the fact that the authority exists under the statute to compel the interrogation.

Let me cite you the language of the Circuit Court of Appeals of the Second Circuit, in *In re Paramount Publix [40] Corporation*. That is to be found in 82 Fed. (2d) at page 230, and the Court said:

“There is a controversy here, however, as to (a) whether the estate is still in the process of administration, and (b) whether the order was improper as granted for the sole purpose of enabling the trustees to prepare their pending suits for trial.

“The estate is still in the process of administration. The Court still retains control over an important asset of the estate, namely, the causes of action set up in the three suits. Section 77B(h) of the Bankruptcy Act (11 USCA, 207 (h)) provides: ‘Upon the termination of the proceedings a final decree shall be entered discharging the trustee or trustees, if any \* \* \* and causing the case.’ See, also, section 2(8) of the act (11 USCA, 11(8)), giving the bankruptcy court jurisdiction to ‘close estates, whenever it appears that they have been fully administered by approving the final accounts and discharging the trustees, and reopen them whenever it appears they were closed before being fully administered.’ These sections contemplate a distinction between the conclusion of the administration of the estate and a formal closing of the estate. There can be a time when the estate is [41] fully administered and yet not closed. Thus the statement in *Skubinsky vs. Bodek*,” citing authorities—“985, 19 Ann. Cas. 1035, that a witness may

be summoned any time after the commencement of proceedings until the estate is closed by order of the court may go too far. However, as long as there is an asset, tangible or intangible, in the court's control, the estate may be considered to be in administration. In *Bilafsky vs. Abraham*, 183 Mass. 401, 67 N.E. 318, an estate was held not to be fully administered under the section last quoted above while the bankrupt had a cause of action not realized upon, and although the estate had been closed, proceedings were reopened to prosecute suit for the benefit of the estate. *Stephan vs. Merchants' Collateral Corp.*, 256 N.Y. 418, 176 N.E. 824, similarly outlined the reopening of an estate as the proper procedure for prosecuting a claim of the bankrupt existant at the time of the closing. This Court, in *re Schreiber*, 23 F. (2d) 428, likewise allowed the reopening of an estate where the bankrupt at the time of closing had an asset consisting of a claim to tax refund. These cases allowing an estate to be reopened, proceeded on the ground that the estate was not fully administered while there was a valid cause of action [42] in favor of the bankrupt. A like situation prevails here. There are assets of the estate outstanding and in the court's control. Trustees are obligated to collect these assets under the direction of the court by Section 47a (2) of the Bankruptcy Act, as amended (11 U.S.C.A. 75(a) (2)), and until its duty is discharged and the assets collected are out of the court's hands, the estate is still in administration. In *re J.A.M.A. Realty Corporation (CCA.)* 79 F.

(2d) 546, holds nothing to the contrary. Anything supporting the appellant's position which can be taken from that case must be regarded as a dictum.

"The appellant's position, that the test of whether the estate is in the process of administration must be determined entirely by the status of the plan for distribution of the assets to the creditors, is not adaptable to 77B proceedings. This statute contemplates continuation of the business and payments by securities of the debtor. The payment of the proceeds of these suits to the debtor will benefit the corporation by strengthening its financial position and its security holders will be correspondingly helped.

"As to the second question, the appellant relies upon a quotation from *In re Fixen & Company*, [43] (D.C.S.D. Cal.) 96 F. 748, 755: 'The examinations thus provided for are not intended as a means of producing testimony pertinent to issues then on trial, but their object is to afford to the creditors, and the officer charged with administering the trust, full information touching the bankrupt's estate in order that necessary steps may be taken for its possession and preservation.' This rule may provide a workable distinction where the issues then on trial are not concerned with recovery of or realization upon the property of the bankrupt."

Citing other authorities, your Honor.

"But even the *Fixen* case says: 'The purpose of the statute seems to be, by a thorough investigation of the case, and an appeal to the conscience

of the party suspected, to enable the assignees to judge whether they will proceed to claim such property for the general creditors, and to obtain evidence to aid them in prosecuting such claim.' To allow an investigation to discover what property the bankrupt might have, and still to disallow an examination where the process of recovery on a claim has gotten under way, would be an absurd result." [44]

Take our situation, your Honor. We have started in to do a thorough job, if we can, in investigating a situation that has already, without the aid of our complete investigation, brought forth one indictment on a situation that the Commission has had before it on an open docket for nearly three years. The statute authorizes us to conduct that investigation. It is totally independent of and bears no relation to any other proceeding or any other remedy of this government.

Under the circumstances, your Honor, I strongly urge upon you an early decision in this matter in behalf of the Commission, otherwise the whole purport of the Securities Act, so far as these people are concerned, may be, to use the language of the Supreme Court, "frittered away." Thank you, your Honor.

Mr. Clark: If your Honor please, I shall detain you only for a moment. I confess lack of familiarity with the cases which counsel has cited, but as to the general law of contempt I think I should be regarded as able to speak with that positiveness which arises from the fact, which your Honor



takes judicial notice of, that I come in on contempt in more ways and more times than any other member of the Bar.

The Court: Well, I think several people are running you a close second lately. [45]

Mr. Clark: Now, my function here is to direct your Honor's attention to the factual situation with which I am possibly more familiar than Mr. Lavine, as long as Mr. Lavine was out of the city at the time the letter attached to the affidavit was written, and, consequently, that affidavit and the attached matter came to my attention rather than to Mr. Lavine's, and he has not had time to examine it carefully.

Now, I am going to lay down as a premise for the purposes of this motion a fact not alleged in the affidavit, or in the accompanying papers, and, therefore considered as one that does not exist. Having in mind that when I came into court the other day counsel challenged my good faith, I am going to say to your Honor, that while I was challenged as to my good faith, it is impossible for me to believe that the officers who presented this affidavit have exercised that great degree of candor which I would have expected those officers involved to exercise. They have attached a copy of the letter addressed to the Penfield Company of California, 1527 South Robertson Boulevard, but they state in their affidavit that he called at the office of the Penfield Company. But they do not state that they called at 1527 Robertson Boulevard, for the reason that they could not state so truthfully.

Thus, so far as the original letter is concerned, the presumption is that it was mailed to an address where it never reached the Penfield [46] Company at all. They state that they addressed a letter to Mr. Young at a certain place, but they do not state that that place is his residence. And I have no knowledge that it is. But if it was his residence, I assume they would have stated so. They state they addressed another letter to Mr. Lavine's office, but they failed to state the information which they received from that office, and which, if it was stated, would throw a flood of light upon their further statements that they called at the office of the company and were refused the papers. They are very careful to state they did not demand the papers, or not to state they demanded the papers of Mr. Young, while Mr. Young was there, or that Mr. Young refused them access to the papers. Everything that they have alleged in their affidavit is perfectly consistent with the fact that their letter to Mr. Young never reached him, and that Mr. Young had no knowledge that they were going to demand an inspection of the papers at the time they attached or they made their demand.

Now, I submit in all frankness and all candor if that evidence were before the court, and no further than that, on this preliminary showing, that this is sufficient to sustain the jurisdiction of the court to make a finding that this matter of contempt would not be before the court; and if an order to show cause is going to issue, I respectfully suggest that it should not issue until such [47]

facts as to make a prima facie showing that contempt has been committed by Mr. Young are presented. In other words, until they have shown by a prima facie case, that Mr. Young had knowledge of their intention to visit the office for the purpose of the inspection at the time that they say they made this, or that Mr. Young was there, or that a refusal was made with Mr. Young's knowledge and under his direction.

Mr. Lavine: May I add another remark to that, your Honor? I have listened to the very able argument of Mr. Townsend on the question generally applicable to various contempt proceedings and his attempt to distinguish those cases from this case as a civil procedure, rather than a criminal one, in its nature. I think your Honor has the right and duty to consider all of the proceedings had.

Now, we have here a very unusual set of facts. Now, before the Circuit Court of Appeals a Mr. A. Judy said:

"I am the Regional Administrator of the San Francisco Regional Office of the Securities & Exchange Commission; I am one of the attorneys of record appearing on behalf of the Securities & Exchange Commission in this matter and am fully acquainted with the facts therein set forth."

And then he refers to various matters that had preceded, and he says that the subpoena he is seeking to enforce [48] was issued in the course of an investigation by the appellee to determine whether the appellant in the course of the sale of securities had violated the registration provisions, Section

5 (a) of the Anti-Fraud Provisions, of Section 17 (a) of the Code, 15 U. S. Code, Section 77 (a) and 79 Q(a), and that such investigation may result in the institution of an injunctive action under Section 20 (b) of the Code of Criminal Prosecutions for wilfully violating Section 24, 15 U. S. Code, Section 77 (m).

Now, I think the court may note that thereafter the same ones were subpoenaed prior to the Grand Jury investigation, by the Grand Jury, that the original documents were sought, and that thereafter the Grand Jury returned an indictment.

Now, the function of the Securities & Exchange Commission, as set forth in the statute and the decisions regarding the Securities & Exchange Commissions, is that it performs a similar and distinct function to that of the Grand Jury, and when that object has been completed, its function has been exhausted.

It appears that the Securities & Exchange Commission prepared, apparently, all of the papers, and unless Mr. Townsend is unfamiliar with it, I think it is very evident that the subpoena is identical, and that the matters presented in the indictment are matters which were gathered by the Securities & Exchange Commission and presented to [49] the Grand Jury when that body was in session for the return of the indictment.

Now, the matter cannot be said to be civil where their object was to secure an indictment, and they have secured it and their function has been completed.

Your Honor can certainly take judicial notice of the fact that is the same subpoena, the same nature, the same request, the same thing, and in both instances how can they say they were seeking something different, or that they are seeking a different object than what the Grand Jury sought when it was presented to them? It is asking your Honor to close your eyes to the actual facts as they exist. We are submitting the matter.

The Court: As to the point which Mr. Clark made, whether or not there was a *prima facie* showing, are you prepared to discuss that?

Mr. Townsend: Well, your Honor, I think so.

The Court: The order was made directing A. W. Young, Secretary-Treasurer—you have the order before you?

Mr. Townsend: Yes, your Honor.

The Court: —A. W. Young, to appear before the Securities & Exchange Commission, Room 1737, in the United States Post Office, to produce the following documents:

“It is further ordered in accordance with the stipulation and agreement of the parties made in open court that [50] the books, papers, and documents herein ordered to be produced, as aforesaid, in lieu of their physical production, as heretofore ordered, shall be made available to such officers and employees of the Securities & Exchange Commission as may be designated at the office of Respondent at 8900 Beverly Boulevard, Los Angeles, California.”

Now, I don't think that the points which Mr.

Clark makes are minor ones. I mean, because of my experience with contempt matters, it is my opinion your matter in your *prima facie* showing must be accurate; if that were always the case, there would not be so many reversals in contempt cases by the Appellate Courts. The affidavit, I think, is in order with the order.

Mr. Townsend: Yes, your Honor.

The Court: Showing the change of dates, and the designation of the change of place, for instance. I don't think those are material. But in view of the stipulation of their failure to produce them in the Federal Building, at this office——

Mr. Townsend: Yes, your Honor.

The Court: ——but that they would be produced at this address, and there being no showing that this address is the address, or that there has been any change of address of the Penfield Company, and there being no showing that a demand was made on January 24, 1945, and that at that time and place—the place is not indicated—they [51] had ability to comply.

Mr. Townsend: They had the ability to comply.

The Court: There is no indication here that they had the ability to comply, and I think you laid down the rule that the only thing that the court could take into consideration was whether or not they had the ability to comply.

Mr. Townsend: That is their answer to the rule.

The Court: I think you must show that the demand was made at the time and place mentioned in the order.

Mr. Townsend: I certainly think the affidavit shows that, your Honor. We have alleged that.

The Court: That is possibly so.

Mr. Townsend: I am perfectly willing to take evidence on the question right now, your Honor.

The Court: I have not examined it with that point in mind. It did not occur to me until Mr. Clark suggested it.

Mr. Townsend: Your Honor, there is a short answer to that. They are here and appearing in opposition to the motion which certainly evidences that counsel received a copy. There is no need for government counsel, we submit, to show more than that counsel of record in this case had the notice of the rule that your Honor issued.

The Court: I think that is correct if it is here.

Mr. Townsend: Yes. [52]

The Court: I believe that you are correct. I think the points that Mr. Clark made would go to the question of the sufficiency of a showing upon a rule to show cause.

Mr. Townsend: Yes, your Honor.

The Court: But for this purpose I think this affidavit is sufficient.

Mr. Townsend: Yes.

The Court: The rule to show cause will issue. And if you will prepare a form and submit it to counsel under our rules for approval or objection as to form, you may do that. You will provide in it that the order must be served, however, by the marshal, because whether you are correct or whether you are not correct as to the law, and I am in-

clined to think you are incorrect, the rules provide, nevertheless, that the court may, in its discretion, order service to be made by the marshal or provide that the service of the order shall be made by the marshal. I will fix the return date. What day is this set for trial?

Mr. Lavine: We have stipulated it will go until April 10th, your Honor.

The Court: To begin?

Mr. Lavine: Yes, to begin.

The Court: Well, I will make the return date. I wish to make this observation, that whether you are correct, Mr. Townsend, or not, in connection with this procedure being entirely independent of the Grand Jury proceeding, the court [53] is bound to observe in taking judicial notice of this matter, that each one of the subpoenas seek the identical thing, and in view of the fact you have returned an indictment against the defendants, the urgency of the statute of limitations against them has now passed in the criminal matters; however, the Securities & Exchange Commission may have administrative matters upon which there is no statute of limitation, or civil matters upon which there is no statute of limitation, so it seems to me perhaps this matter might well be heard on the contempt after the conclusion of the criminal trial.

Mr. Townsend: Your Honor, it may very well develop that other defendants could be located in connection with the very criminal case that is now pending before your Honor, and a new indictment obtained which might supersede the old one.



The Court: I take cognizance of the provision in Rule 1 of the Rules of Civil Procedure, that the very first thing mentioned is that the rule shall be construed so that there shall be justice.

Mr. Townsend: And speedy.

The Court: And speedy, but justice first.

Mr. Townsend: Yes, your Honor.

The Court: And it seems to me that in view of the fact that you now have the indictment of these people, certainly the government does not want to accumulate [54] penalties on top of these defendants. I mean a whole series of them. I feel that justice would be served if the hearing on this matter were postponed until after the trial of the criminal matter. I would have to hear both of them and I believe it would be fair to them and better for the public interest if this matter were heard after that date. I will, however, make the return date on your rule before that date. But I feel as though I should, in having this intention to make it before that date, make this announcement which I have just stated concerning my views.

Mr. Townsend: In other words, your Honor, you will have to determine that, however, regardless of the showing made on the rule today. [55]

The Court: Yes.

Mr. Townsend: Your determination or decision on the matter will be postponed?

The Court: That is presently my opinion. I will make the return day before then so as to give both government and the defendant an opportunity to say whatever they desire.

Mr. Townsend: Yes, I see, your Honor. Thank you.

The Court: And it may be, at that time, facts might occur which, in my judgment, would require, in the interest of justice, an earlier hearing on the contempt matter.

Mr. Townsend: Under those circumstances, may I request your Honor to fix the time within which we might file with your Honor, prior to the return day, anything in the nature of affidavits or observations that may seem appropriate?

The Court: I think that whatever affidavits you expect to rely upon should be made and served with the return.

Mr. Townsend: Today?

The Court: Oh, no. Today I am simply making an oral order.

Mr. Townsend: I see.

The Court: That the rule shall issue.

Mr. Townsend: Yes.

The Court: You may prepare a form and support it with whatever affidavits you desire, and provide in the order that it and the affidavits shall be served by the marshal. The return day I will now fix. [56]

Mr. Townsend: Yes, your Honor.

The Court: With the idea that my present opinion is, that you return at that time, and I will not that day try the rule, but give consideration to whether or not it should be tried before or after the criminal case. Is that clear?

Mr. Townsend: Yes.

Mr. Bell: In view of the fact that you have mentioned the criminal matter, I would like to say just one thing, namely, that, as I indicated during my own discussion, the investigation of the Grand Jury up to that time indicated there were quite a number of other defendants as to whom proof or evidence was inconclusive, showing that in their minds they needed additional evidence. Now, that evidence, one way or the other, whether it would or would not incriminate them, may be found in the books of the Penfield Company of California.

The Court: It may, no doubt, develop in the trial, because I cannot overlook the fact you are going to have a trial and a great many things may develop which will clarify the whole situation, no doubt.

Mr. Bell: There is one point I wanted to make. The statute of limitations is more or less clipping at the heels of this very case, and those other persons are not yet indicted. Consequently, it may be too late after the return date on this other matter.

The Court: Well, we will expedite the trial, if you [57] have to have witness on the trial, and we will set it down beforehand so that the matter can be disposed of. What would be a convenient date for the return date of this rule? This is February 8th. March 5th? Is that ample time?

Mr. Townsend: Yes, your Honor. The 5th will be fine.

The Court: We will fix the date as March 5th for the return of the rule, at 10:00 o'clock.

Mr. Lavine: That is very satisfactory to me at this time, but I have this one observation to make.

The Circuit Court of Appeals will be here on March 5th and they have set five cases that I have pending up there, and if I could have another time, it might be better.

Mr. Townsend: Earlier, your Honor, would be agreeable to us.

The Court: Well, February 26th. That is a week before that.

Mr. Townsend: Yes, your Honor.

The Court: It is a matter of giving the government time to prepare their affidavits.

Mr. Townsend: The 26th? That is fine.

The Court: I think I would prefer to set it for the 26th and at that time we will determine whether or not we will proceed to hear the rule or postpone it until after the trial of the criminal case.

Mr. Townsend: Yes, your Honor.

The Court: If you wish to file points and authorities, [58] I suggest you file them with your return on the rule.

Mr. Townsend: With the return on the rule?

The Court: Yes, if you desire. I would like them sufficiently in advance.

Mr. Townsend: I will get them to you just as quickly as I can have them typed.

The Court: If Mr. Lavine desires to file contradictory authorities, he may.

Mr. Lavine: I will have some time in February to file them, but in March I will not.

The Court: All right.

[Endorsed]: Filed Oct. 4, 1945. [59]

Los Angeles, California,

Monday, July 2, 1945, 10:00 a. m.

(Other Court matters.)

The Court: Call the Civil calendar.

The Clerk: No. 2863, Civil, Securities and Exchange Commission v. Penfield Company of California.

Mr. Lavine: Ready, your Honor.

In that matter, we have two affidavits which I have served on counsel and which we wish to file.

The affidavits, in substance, show that Mr. Young was not in the city at the time the notice was sent, nor at the date required or asked for him to appear, which was January 24, 1945. He was out of the city and out of the state. Further, that his counsel was also out of the city and out of the state at that time. His counsel was then in Washington in the East.

Mr. Cuthbertson: This matter has been pending before this Court for over two years. I wonder if the Court would be helped if I made an outline of the chronology of the dates?

Mr. Lavine: I think we tried this case a short time ago.

Mr. Cuthbertson: This is something entirely different from a criminal case.

Mr. Lavine: The Court tried the civil matter too.

The Court: Does this arise out of the civil pro-

ceeding which was in this Court and went to the Circuit Court: [2\*]

Mr. Lavine: Yes, your Honor.

The Court: This is the same order involving originally there?

Mr. Lavine: That is correct, your Honor.

The Court: This then is a trial on the merits of the contempt?

Mr. Cuthbertson: This is the order to show cause for the contempt, yes.

The Court: You are ready to proceed?

Mr. Cuthbertson: We are.

The Court: Are you ready?

Mr. Lavine: Yes, we are ready.

The Court: I will mark it ready.

The Court: We will proceed with the Penfield matter right now. Are you ready?

Mr. Lavine: Yes, your Honor.

Mr. Cuthbertson: I think in a contempt proceeding of this nature the burden of proof is upon the plaintiff or moving party as far as the facts are concerned. I think that burden of proof was met with the affidavit which was filed in this Court on January 24th of this year.

This matter has been pending for over two years. On May 14, 1942 the Securities and Exchange Commission issued an order directing an investigation to be made. [3]

The Court: Just a moment. I want to find your affidavit and order to show cause for a contempt proceeding.

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\*Page numbering appearing at top of page of original Reporter's Transcript.

Mr. Cuthbertson: That was filed on January 24th of this year. It sets forth the facts which I was about to outline to the Court. I thought I would save the Court the trouble of reading it.

The Court: Go ahead.

Mr. Cuthbertson: On May 14, 1942 the Commission issued this order directing its Los Angeles office and other offices to commence an investigation of certain matters, certain activities of the Penfield Company which the Commission was convinced constituted violations of the Securities Act of 1933.

An order was made appointing Charles R. Burr, among others, as officers with certain powers. The powers which were given by statutes and by law to these officers is set forth rather broadly and I would like to read it to the Court, Section 19 (b) of the Securities Act of 1933.

The Court: I think their powers are all right. I held that it was originally, and that was later affirmed by the Circuit Court.

Mr. Cuthbertson: Acting under that order and with those powers, the Commission issued a subpoena dated April 19, 1943 directing the Penfield Company to produce certain books and records of that corporation. That subpoena was disobeyed. Under Section 22 (c) of the Act, which provides [4] that where such a subpoena is not obeyed the remedy of the Commission will be to come before a District Court, and the Court then upon a proper showing is required to order that the subpoena be obeyed. That was done in this case. A hearing was held here several days, I understand—that was

before I was associated with the Commission—and on June 1, 1943 this Court ordered that the books and records specified in the subpoena should be produced before the Securities and Exchange Commission on June 8 of 1943.

An appeal was then taken by the respondent and, after lengthy appeal time, on December 7, 1944, it reached the Supreme Court of the United States and it denied the petition for a certiorari.

Then acting under the powers which the officers appointed by the order had, on January 16th there was served upon the respondent Young by mail, and I am informed also by mail a notice was sent to his counsel, directing him to produce those books and records on January 24th.

Now I am not at all sure that that sort of a step was necessary inasmuch as this Court had made an order directing that the subpoena be obeyed and the books and records be produced—that was stayed during the force and effect of the appeal—but on December 7, 1944, when the mandate came down from the Circuit Court and was spread on the records of this Court, I think there was a positive duty then on the part of the respondent to, within a reasonable time, comply with the [5] order of the Court. That was not done, and on January 24th we came before this Court with an affidavit and an order to show cause and asked that the order issue. The return date set forth by the Court was February 5, 1945, and the matter had been continued then to these various dates, February 8,



1945, then February 26, from February 26 to May 28, to July 25 and to today.

I think it clearly shows disrespect and contempt for the Court's order made over two years ago when we are met this late date with the type of affidavit of the type and nature the respondent has filed.

The Court: Let me get straight on some of these dates.

The mandate was spread on December 7, 1944. Then after that the Commission amended the order of designation of the examining officer that was involved in the amendment.

Mr. Cuthbertson: I am not certain of that.

The Court: It says here that it was further amended by the designation of Charles R. Burr.

Mr. Cuthbertson: My impression was he had been appointed some time prior to that.

The Court: Well, it appears here it was on January 6th. I suppose for that reason that the letter was addressed to Mr. Young because there was a different person for him to appear before than that contained in the mandate.

What did you say happened in February?

Mr. Cuthbertson: Nothing happened. [6]

The Court: You said this order directed him to appear on January 24th.

Mr. Cuthbertson: That is right. The return date of the order to show cause which was obtained on January 24th was February 5, 1945.

The Court: That was just the order to show cause on this contempt?

Mr. Cuthbertson: Yes, your Honor.

The Court: All right, May I hear from you?

Mr. Lavine: We have submitted the affidavits to counsel and, as your Honor has pointed out, the only thing we have done here is send a letter with a new officer stating that Mr. Burr was going to call at the offices of the Penfield Company on January 24, 1945. Now Mr. Burr was not the person who was designated and, according to the affidavits of Mr. Young and his wife, he was out of the city at the time, and his counsel was out of the city also at the time. He was not back in the city until February. So it was merely a request by Mr. Burr. There was no subpoena or any other notice served on Mr. Young other than a letter in the form of this letter by Mr. Burr, who was not the officer designated in the former order. He said he would call, and that is all they did. I think that is insufficient upon which to predicate a contempt proceeding which is a quasi-criminal proceeding in this matter.

The Court: The order that was made on June 1, 1943 and [7] from which the appeal was taken ordered and directed Young to produce certain books and records or, in accordance with the stipulation and agreement of the parties made in open court, that the books, papers and documents herein ordered to be produced as aforesaid in lieu of their physical production as heretofore ordered shall be made available to such officer and employees of the Securities and Exchange Commission as may be

designated at the office of the respondent at 8900 Beverly Boulevard, Los Angeles, California.

Now it does not appear to me that there was any particular person designated in the order, it was an officer of the Securities and Exchange Commission. Now they merely advised Young that they would call on January 24th. They did call on January 24th, according to the affidavit, which is not denied, at 8900 Beverly Boulevard.

Mr. Lavine: We can't tell, your Honor. The letter is addressed to another address.

The Court: What letter?

Mr. Lavine: The letter of Mr. Burr to Mr. Young, is addressed to 2427 South Robertson Boulevard.

The Court: Yes, it is, and it says that they presented themselves at the office of the Penfield Company of Los Angeles. I don't know whether that was 8900 Beverly Boulevard or not.

Mr. Cuthbertson: I am informed by Mr. Burr, whose affidavit that is, that they called at the Beverly Hills office [8] and also at the Robertson address.

The Court: It isn't in the affidavit. Do you wish to put him on the witness stand?

Mr. Lavine: I don't.

The Court: The affidavit of the defendant Young indicates that he was absent from the city from January 11 to February 3, so the question now is whether or not his mere absence from the city is sufficient to exculpate him from the order of the Court.

I think that the order is pretty definite, that he should have made the books and records available to Mr. Burr, and even though he were absent from the city I think he should have made some provision so that the examination could have been had, because the order to produce the books and records was made in the alternative, to examine them at their office as an accommodation to the defendant in order to prevent him from having to physically bring the books and papers to the office and interrupt his business. I think the order is definite enough that it should have been obeyed.

The question now is whether or not, as I have indicated, his absence from the city is sufficient to excuse him. I don't believe that it is, Mr. Lavine. I think that he should have provided some means or some person so that they could have been available.

Mr. Lavine: Your Honor, might I call your attention to the fact that the mandate, while the mandate came down in [9] December, that some time in January or—I am not sure as to the time, but subsequent to the December time—there was a request made for these books and instead of making the request to Mr. Young they sought out Mr. Black, who was the president of the Penfield Company, and they served papers on him. He made a return with respect to those, and the hearing was had before McCormick in respect to that.

The Court: That was in connection with a Grand Jury subpoena?

Mr. Lavine: No, I think it was in connection

with both subpoenas. I think there were two subpoenas served on him.

The Court: That may be possible because the Grand Jury subpoena was transferred to me for hearing.

I think, Mr. Lavine, that the order was definite enough and he knew what was wanted and I think that he ought to be found guilty here of contempt in this matter.

Mr. Young is present?

Mr. Lavine: Yes, your Honor.

The Court: That will be the order of the Court, that he is guilty of contempt.

Are you ready for sentence?

Mr. Lavine: Yes, your Honor.

The Court: Come forward, Mr. Young.

Mr. Young: Might I say a word, your Honor?

The Court: I think you had better talk to your counsel.

Mr. Lavine: Your Honor, the defendant wishes to point [10] out to your Honor that in connection with the matter he was not aware of the time at the time that the mandate came down as to what further proceedings might be had in connection with the matter and he was trying to make a living and went out of the city.

The Court: He had good counsel and if he had consulted him when the mandate came down I think he would have been advised of what he was obliged to do.

Mr. Lavine: Unfortunately I went out of the city too, your Honor, so we were both out of the

city. I want your Honor to take that into consideration.

The Court: Very well. The order will stand that the defendant be adjudged guilty of contempt.

Do you have anything to say in connection with the disposition of this matter, Mr. Cuthbertson?

Mr. Cuthbertson: So far as the punishment which the Court might see fit to impose, that is up to the Court. We are still anxious to get a look at these books and records, so I suggest to the Court, if he be so disposed, whatever punishment the Court might see fit to impose would be in connection with or so long as he refuses to produce his books and records for our inspection.

The Court: I don't think that I am going to be disposed to do anything like that. I sat here for six weeks and listened to books and records. The Government produced people from all over the United States in connection with the [11] Penfield matter.

Mr. Cuthbertson: I might say, your Honor, that we have in mind that these books and records may disclose certain acts other than those charged in the indictment. We don't propose to go over the same matter that the Court went over in connection with the criminal case.

The Court: The Court can take judicial notice of its own books and records, and in that trial the evidence was clear and definite and positive from all of the Government's witnesses, that during one period of time this defendant had nothing whatsoever to do with the Penfield Company. Whether

that period of time is covered by what the Securities and Exchange Commission seeks or not, I don't know.

The judgment and sentence of the Court is that the defendant pay a fine of \$50, and stand committed until paid.

Mr. Lavine: Could we have a couple of hours, your Honor?

The Court: A stay of execution until tomorrow morning at 10:00 o'clock.

[Endorsed]: Filed Oct. 4, 1945. [12]

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[Endorsed]: No. 11173. United States Circuit Court of Appeals for the Ninth Circuit. Securities and Exchange Commission, Appellant, vs. The Penfield Company of California and A. W. Young, Appellees. Transcript of Record. Upon Appeal from the District Court of the United States for the Southern District of California, Central Division.

Filed November 2, 1945.

PAUL P. O'BRIEN

Clerk of the United States Circuit Court of Appeals  
for the Ninth Circuit.

United States Circuit Court of Appeals for the  
Ninth Circuit

No. 11173

SECURITIES AND EXCHANGE COMMIS-  
SION,

Appellant,

v.

THE PENFIELD COMPANY OF CALIFOR-  
NIA

Respondent.

STATEMENT OF POINTS ON WHICH THE  
APPELLANT INTENDS TO RELY

The appellant intends to rely in its appeal upon the point, as listed in the Statement of Points filed with the District Court, that having adjudged Young, the Secretary-Treasurer of the respondent company in contempt, the District Court erred in ordering Young to pay a fine of \$50.00 instead of imposing a remedial penalty calculated to coerce Young to produce or allow inspection of the books and records of the respondent pursuant to the District Court order of June 1, 1943, and;

The parts of the record necessary for a consideration of said point are the items specified in the



Designation of Contents of Record on Appeal dated  
October 2, 1945 and filed with the District Court.

Dated: November 1, 1945.

ROGER S. FOSTER

Solicitor

HOWARD R. JUDY

Regional Administrator

G. M. CUTHBERTSON

Attorneys for Securities and  
Exchange Commission

Received a Copy of the Within Document This  
1st Day of November, 1945.

.....

Attorney for Respondent

[Endorsed]: Filed November 2, 1945. Paul P.  
O'Brien, Clerk.



IN THE  
**United States Circuit Court of Appeals**  
FOR THE NINTH CIRCUIT

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No. 11173

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SECURITIES AND EXCHANGE COMMISSION,  
*Appellant,*

*v.*

THE PENFIELD COMPANY OF CALIFORNIA and  
A. W. YOUNG,  
*Appellees.*

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**BRIEF FOR APPELLANT**

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FILED

JAN 21 1946

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IN THE  
UNITED STATES CIRCUIT COURT OF APPEALS  
FOR THE NINTH CIRCUIT

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No. 11173

---

SECURITIES AND EXCHANGE COMMISSION,  
*Appellant,*  
*v.*

THE PENFIELD COMPANY OF CALIFORNIA and  
A. W. YOUNG,  
*Appellees.*

---

BRIEF FOR APPELLANT

---

STATEMENT OF JURISDICTION

This is an appeal from a final order entered in a civil contempt proceeding in the District Court for the Southern District of California, Central Division, on July 2, 1945 (R. 19).<sup>1</sup> This order fined appellee, A. W. Young, secretary-treasurer of appellee, The Penfield Company of Cali-

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<sup>1</sup> Section 22(b) of the Securities Act of 1933 (15 U.S.C. 77v(b)) provides:

"In case of contumacy or refusal to obey a subpoena issued to any person, any of the said United States courts, within the jurisdiction of which said person guilty of contumacy or refusal to obey is found or resides, upon application by the Commission may issue to such person an order requiring such person to appear before the Commission, or one of its examiners designated by it, there to produce documentary evidence if so ordered, or there to give evidence touching the matter in question; and any failure to obey such order of the court may be punished by said court as a contempt thereof."

fornia ("Penfield"), a corporation, \$50 for contempt, the court rejecting the Commission's request for a coercive decree. Young was adjudged in contempt for disobeying an order of the district court which had been affirmed by this Court, directing him to produce certain books and records of Penfield pursuant to a subpoena *duces tecum* issued by the Commission.

The jurisdiction of this Court is invoked under Section 128 of the Judicial Code, as amended (28 U.S.C. 225), made applicable by Section 22(a) of the Securities Act of 1933 (15 U.S.C. 77v(a)) (the "Act").

## STATEMENT OF FACTS

The Commission, pursuant to Section 20(a) of the Act (15 U.S.C. 77t(a)), issued an order on May 14, 1942, and supplemental orders on February 13, 1943, and April 8, 1943, directing an investigation to determine whether a number of specified companies and persons (Penfield and Young being added in the April 1943 supplemental order) had violated Sections 17(a) and 5(a) of the Act (15 U.S.C. 77q(a) and 77e(a)) in the sale of stock of Penfield and other securities by means of untrue statements of material facts and without registration (R. 2-3, 7; see *Penfield Co. of California v. S.E.C.*, 143 F.2d 746, 747-8 (C.C.A. 9, 1944); cert. denied 323 U.S. 768). In the course of this investigation and pursuant to Section 19(b) of the Act (15 U.S.C. 77s(b)) the Commission directed a subpoena *duces tecum* to Young, as an officer of Penfield (R. 3-4). The subpoena required the production of certain books and records of Penfield covering the four-year period from May 1, 1939, to the date of the subpoena (April 9, 1943). *Penfield Co. of California v. S.E.C.*, *supra*, at 748. Upon Young's refusal to appear and produce the specified books and records, the Commission on April 13, 1943, filed an application in the district court for an order enforcing the subpoena (R. 2, 4; see R. 79).



On June 1, 1943, after hearing, the court granted the Commission's application, specifically ordering Young as secretary-treasurer of Penfield to produce the specified items on June 8, 1943, and at any adjournment dates; and further ordered, pursuant to a stipulation by the parties, that the books and records, in lieu of their physical production at the office of the Commission, should be made available in the office of Penfield to such officer and employees of the Commission as might be designated for such purpose (R. 4-5, 11-15; see R. 3, 7-8). Penfield appealed from this order and, on June 30, 1944, this Court affirmed. 143 F. 2d 746. A petition for a writ of certiorari was denied by the Supreme Court on November 6, 1944. 323 U.S. 768. On November 13, 1944, the mandate of this Court was issued affirming said order of June 1, 1943, and on December 7, 1944, said mandate was filed and spread upon the minutes of the district court (R. 5).

Despite affirmance of this order on appeal the net result of the proceedings to date is that the Commission has been unable to secure compliance. Appellees are permitted to continue to frustrate a federal court order even after its legality has been fully confirmed on appeal. This Court's mandate spread on the district court's records after the Supreme Court had denied certiorari most assuredly put at rest any doubt as to appellees' legal obligation to comply. Following the mandate a designated officer of the Commission on January 16, 1945, addressed and mailed a communication to Young and his attorneys advising that this officer would call at the office of Penfield in Los Angeles on January 24, 1945, for the purpose of examining the books and records referred to in the district court's order of June 1, 1943 (R. 6, 9-10; see R. 80). On January 24, 1945, the said officer and another designated officer of the Commission presented themselves at the office of Penfield and demanded to see the specified books and records but such demand was refused (R. 6-7).

On January 24, 1945, the Commission instituted civil contempt proceedings against Young in the district court

by filing a proposed rule to show cause why Young should not be adjudged in contempt, together with an affidavit in support of the rule (R. 2-15). The court below declined to issue the rule immediately but instead directed Young to show cause on February 5, 1945, why a further order should not be made directing Young to show cause why an order should not be made holding him in contempt of court (R. 15-16; 31). After hearing both sides on February 8, 1945, the court expressed doubt as to whether the Commission was entitled to obtain the evidence sought for until after the conclusion of a pending criminal trial involving Young, Penfield and others<sup>2</sup> because that evidence might be used by the Government (R. 72, 73). The court issued an order to show cause returnable on February 26, 1945 (R. 17-18), and stated that it would on that date decide whether or not to proceed with the contempt proceedings or postpone the matter until after the criminal trial (R. 76).

On February 26, 1945, the court, over objection of Commission counsel, postponed the hearing on the order to show cause to May 28, 1945, then to June 25, 1945, and then to July 2, 1945, when the matter finally came on to be heard (R. 80-1), and on that date the court below adjudged Young to be in contempt, but refused to grant a remedial decree calculated to coerce production of Penfield's books and records (R. 86). Instead, the court ordered Young merely to "pay a fine of \$50, and stand committed until paid", with execution stayed temporarily, presumably to give Young an opportunity to pay the \$50 (R. 87). It is from this order that the Commission appeals.

## SPECIFICATION OF ERROR

The court below erred in refusing to enter a remedial order calculated to coerce production of the records. The contempt proceeding was instituted by the Commission to obtain compliance with an order of the district court re-

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<sup>2</sup> See note 4, *infra*.

quiring Young to produce certain books and records of Penfield pursuant to a subpoena issued by the Commission under the Securities Act of 1933. The proceeding was civil in nature, and upon a finding of contempt, the court should have entered a remedial and coercive decree designed to obtain compliance, instead of the mere penalty for past dereliction which the court imposed.

## ARGUMENT

THE CONTEMPT PROCEEDING WAS CIVIL IN NATURE AND THEREFORE, HAVING FOUND YOUNG IN CONTEMPT, THE COURT BELOW ERRED IN FAILING TO ENTER A REMEDIAL AND COERCIVE DECREE.

The instant proceeding, which was instituted by the Commission against Young to obtain compliance with the district court's order of June 1, 1943, directing production of the records, was one for civil contempt. It is captioned as a civil action (R. 2, 11, 25). It was called on the civil calendar (R. 77). Counsel for the Commission stated that the proceeding was for civil contempt (R. 35-39, 43, 77).<sup>3</sup> It meets the tests laid down by the courts in determining that a contempt proceeding is civil in nature. It was instituted by the Commission, not by the United States nor by the court to vindicate its authority. *McCrone v. United States*, 307 U.S. 61 (1939); *Western Fruit Growers, Inc., v. Gotfried*, 136 F. 2d 98, 100-01 (C.C.A. 9, 1943); *McCann v. New York Stock Exchange*, 80 F. 2d 211, 214 (C.C.A. 2, 1935), cert. denied 299 U.S. 603; *Norstrom v. Wahl*, 41 F. 2d 910, 913 (C.C.A. 7, 1930). It was a continuation of the earlier civil action in the district court to enforce the Commission's subpoena (see R. 77-8), and was a step in the enforcement of the district court's order of June 1, 1943 (which this Court had affirmed). *N.L.R.B. v. Hopwood Retinning Co.*, 104 F. 2d 302, 305 (C.C.A. 2, 1939); *Gompers v. Bucks Stove & Range Co.*, 221 U.S. 418, 444-5 (1911); cf. *I.C.C. v. Brimson*, 154 U.S. 447, 470 (1894). Its purpose was remedial, to obtain compliance with the subpoena enforcement order. *N.L.R.B. v. Hopwood Retinning Co.*, *supra*, at 305; *N.L.R.B. v. Carlisle Lumber Co.*, 108 F. 2d 188 (C.C.A. 9, 1939); *McCrone v. United States*, *supra*, at

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<sup>3</sup> Counsel for Young recognized the civil nature of the proceeding by citing the Rules of Civil Procedure to support one of his contentions at the February 8, 1945, hearing (R. 27).

64. Upon a judgment for civil contempt, the punishment must be remedial and for the benefit of the complainant. *McCann v. New York Stock Exchange, supra*; *Norstrom v. Wahl, supra*.

Having adjudged Young to be in contempt in a civil contempt proceeding, the court below had no discretion but to impose a remedial, coercive penalty designed to compel compliance with the mandate of this Court. *Oriel v. Russell*, 278 U.S. 358 (1929) ; *Gompers v. Bucks Stove & Range Co.*, 221 U.S. 418 (1911) ; *Clarke v. Federal Trade Commission*, 128 F.2d 542 (C.C.A. 9, 1942). In the *Clarke* case, the Federal Trade Commission subpoenaed a witness to appear and testify at a hearing before that commission. The witness appeared but declined to answer any questions. The Federal Trade Commission obtained a subpoena enforcement order in the district court. The witness disobeyed the order by refusing to answer a certain question put to him. The commission instituted civil contempt proceedings, and the witness was adjudged in contempt and committed until he should answer the particular question. On appeal, this Court affirmed the contempt order, saying at page 543:

“The party or the witness has no alternative but to obey or be held in contempt”.

Since, in the instant case, the order of June 1, 1943, affirmed by this Court, required performance of an affirmative act, namely, the production of Penfield's books and records, the proper penalty was imprisonment unless and until the order was complied with. *Gompers v. Bucks Stove & Range Co., supra*; *Clarke v. Federal Trade Commission, supra*. In the *Gompers* case the court said, at page 442:

“ . . . Imprisonment for civil contempt is ordered where the defendant has refused to do an affirmative act required by the provisions of an order which, either in form or substance, was mandatory in its character. Imprisonment in such cases is not inflicted as a punishment, but is intended to be remedial by coercing the

defendant to do what he had refused to do. The decree in such cases is that the defendant stand committed unless and until he performs the affirmative act required by the court's order. \* \* \* If imprisoned, as aptly said in *In re Nevitt*, 117 Fed. Rep. 451, 'he carries the keys of his prison in his own pocket.' He can end the sentence and discharge himself at any moment by doing what he had previously refused to do."

It was therefore reversible error to impose the \$50 fine merely to penalize in that manner the past disobedience of the order. The record clearly shows that, even though the order of June 1, 1943, had been confirmed on appeal and hence was final in every respect, the court did not intend to coerce Young into compliance therewith. This is made plain not only by the character of the judgment (R. 87), but also by concurrent statements from the bench (R. 86):

"The Court: . . . The order will stand that the defendant be adjudged guilty of contempt.

Do you have anything to say in connection with the disposition of this matter, Mr. Cuthbertson?

Mr. Cuthbertson [Commission counsel]: So far as the punishment which the Court might see fit to impose, that is up to the Court. We are still anxious to get a look at these books and records, so I suggest to the Court, if he be so disposed, whatever punishment the Court might see fit to impose would be in connection with or so long as he refuses to produce his books and records for our inspection.

The Court: I don't think that I am going to be disposed to do anything like that."

We have shown that the court below, upon adjudging Young in contempt, had no discretion to deny a remedial order. Furthermore, even assuming *arguendo* that there was room for discretion in this case, it is clear that the reason given by the court for refusing a coercive order afforded no valid basis for such refusal. The colloquy between the court and counsel for the Commission (R. 86-7) indicates that the court's refusal to impose a remedial

penalty was based upon its opinion that in the criminal trial of Penfield, Young and others:<sup>4</sup>

“the evidence was clear and definite and positive from all of the Government’s witnesses, that during one period of time this defendant [Young] had nothing whatsoever to do with the Penfield Company. Whether that period of time is covered by what the Securities and Exchange Commission seeks or not, I don’t know.”

The continuity or extent of Young’s association with Penfield furnished no justification for refusing to render a coercive decree calculated to obtain compliance with the district court’s order of June 1, 1943, affirmed by this Court.<sup>5</sup> Young, as an officer of Penfield, was subpoenaed to produce Penfield’s books and record, not his own. The district court’s order directed that they be produced for the Commission’s inspection. Young’s guilt or innocence with respect to any new violation uncovered in an examination of the books has no bearing on the only issues which were before the court, viz., whether Young was able to comply with the mandate, and whether his failure to comply was wilful. *Oriel v. Russell*, 278 U.S. 358 (1929). The court below by finding Young in contempt indicated that in its judgment he was able, but wilfully refusing, however, to produce the books (R. 85, 86). Hence, as we have shown, the court erred in failing to grant a remedial decree.

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<sup>4</sup> This trial was upon an indictment returned in the District Court for the Southern District of California on September 29, 1944 (No. 17230), charging violations of the Securities Act (Section 17(a) (1), 15 U.S.C. 77q(a) (1)), the mail fraud statute, and the conspiracy statute (see R. 28, 32-33, 47).

It is interesting to note that the books and records here involved were not even produced at the criminal trial to which the court adverted.

<sup>5</sup> Moreover, collateral attack on the subpoena enforcement order is not permissible. *Clarke v. Federal Trade Commission*, 128 F. 2d 542 (C.C.A. 9, 1942); *E. Ingraham Co. v. Germanow*, 4 F. 2d 1002, 1003 (C.C.A. 2, 1925). We have some difficulty, in any case, in understanding how the court could know in advance of the examination of the records in question, what, if anything, they would show.

The court below may have been actuated by some feeling that disposition of the criminal case prior to July 2, 1945, when the court finally heard and ruled on the order to show cause, rendered moot the application for a remedial decree (R. 86; cf. R. 48, 72). Actually, it is evident that legally the application is not moot. The date of the subpoena (April 9, 1943) shows clearly that the statute of limitations has not barred further prosecution, and the books may furnish leads to later violations. Moreover, as shown below, other proceedings are still open.

In any event, it should not lie in the mouths of appellees to object to enforcement of the district court's order on the ground of possible fruitlessness of the inquiry when their own obstructive tactics have thus far prevented the examination of the books. Certainly, appellee's contumacy makes it all the more important that the Commission be given every opportunity to scrutinize the books and records for such evidence as they may afford in aid of its investigation. Surely the delay caused by appellee's wilful disobedience should not result in any restrictive forecasts of the probable results of the examination of the books. Otherwise appellees would be profiting from their own wrong.

*The Erroneous Order Not Only Results in Defeating the Commission's Investigatory Powers Under the Act, But It Also Tends to Negate the Authority and Finality of Judicial Orders Confirmed on Appeal.*

The Commission's investigation has sought to ascertain the facts disclosed by the books in question. These facts alone or in conjunction with other evidence might justify injunctive proceedings by the Commission (R. 67-68), administrative proceedings before the Commission, or further criminal proceedings by the United States Attorney against Penfield, Young or any other persons or companies who may be shown to have violated the Act (R. 48, 75). Examination of the records specified in the Commission's subpoena of April 9, 1943, and the district court's order of



June 1, 1943, may disclose violations within the period of limitations, either from the books and records alone (e.g., cancelled checks, correspondence, books of accounts, lists, etc. (see R. 12)), or from the books together with other information to which the books should furnish leads. Indeed, it is pertinent to note here that the Commission's orders for investigation herein specifically recite as being under investigation a number of persons other than those named as co-defendants in the criminal proceeding brought against Penfield and Young (R. 7-8). As this Court said in *Consolidated Mines of California v. S.E.C.*, 97 F.2d 704, 708 (C.C.A. 9, 1938) :

"Investigations of the sort here under consideration are analogous to those of a grand jury. In re Securities and Exchange Commission [84 F.2d 316 (C.C.A. 2, 1936)]; *Woolley v. United States*, [97 F.2d 258 (C.C.A. 9, 1938)]. The scope of the inquiries of a grand jury, it has been said, is 'not to be limited narrowly by questions of propriety or forecasts of the probable result of the investigation, or by doubts whether any particular individual will be found properly subject to an accusation of crime. As has been said before, the identity of the offender, and the precise nature of the offense, if there be one, normally are developed at the conclusion of the grand jury's labors, not at the beginning.' *Blair v. United States*, 250 U.S. 273, 39 S. Ct. 468, 471, 63 L. Ed. 979."

The Commission, as the agency designated by the Congress to enforce the Act, was entitled to the support of the court in its effort to ascertain the facts. The investigative powers given to the Commission under the Act (Sections 19 to 22, 15 U.S.C. Sections 77s-v), particularly the provision giving the Commission the right to compel testimony over claim of privilege (Section 22(c)), demonstrate the legislative intent that everything possible should be done to aid the Commission to uncover the facts, and that its investigations should not be permitted to be delayed or forestalled by the contumacy of persons who have been subpoenaed to produce evidence. In the instant case appellees

have succeeded in avoiding production of the subpoenaed records even after final adjudication by the appellate courts of the Commission's right to examine the books and records. This they have accomplished by arrant disobedience of the district court's order to produce the records. The failure of the court below to enter a coercive decree would seem to countenance continued disobedience of that order.

It is submitted that the order under review tends not only to strike at the roots of the Commission's enforcement functions, but also in our view has a clear tendency to set at naught the authority of the judiciary. The power to punish for contempt for disobedience of a judicial order is inherent in the courts, and its exercise in proper cases is essential. Otherwise the judicial power would be rendered impotent. *Myers v. U. S.*, 264 U.S. 95, 103 (1924) ; *Bessette v. W. B. Conkey Company*, 194 U.S. 324 (1904). The courts do not look with favor upon such lessening of the authority and finality of their mandates as would seem to flow from the decision of the court below in refusing to secure compliance with the district court's order through the readily available sanction of a coercive and remedial decree. As stated in *Oriel v. Russell*, 278 U.S. 358, 366 (1929) : " 'Imprisonment to compel obedience to a lawful judicial order [must be ordered] unless it should be thought expedient to destroy all respect for the courts by stripping them of power to enforce their lawful decrees.' " The Supreme Court also said in *Gompers v. Bucks Stove & Range Co.*, 221 U.S. 418, 450 :

" . . . the power of courts to punish for contempts is a necessary and integral part of the independence of the judiciary, and is absolutely essential to the performance of the duties imposed on them by law. Without it they are mere boards of arbitration whose judgments and decrees would be only advisory.

"If a party can make himself a judge of the validity of orders which have been issued, and by his own act of disobedience set them aside, then are the courts impotent, and what the Constitution now fittingly calls the 'judicial power of the United States' would be a mere mockery."

Moreover, as stated in *Cobbledick v. U.S.*, 309 U.S. 323, 325 (1940), "To be effective, judicial administration must not be leaden-footed."<sup>6</sup>

Affirmance by the courts of the clear right of administrative agencies to subpoena enforcement orders<sup>7</sup> would have no practical consequence, if respondents can delay compliance pending meritless appeals from an enforcement order, and thereafter flout with impunity a court order affirmed on appeal. Imposition of a nominal fine for contempt of an order affirmed on appeal is an even more serious threat to effective enforcement of the securities laws than failure to enter a required enforcement order in the first place. We submit that effective enforcement requires an affirmation of the clear duty of the district court to compel respect for its own enforcement order and that this can be accomplished

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<sup>6</sup> The district court's mistaken view that it had a wide discretion with respect to enforcement of the Commission's investigatory powers is also indicated by its several rulings postponing the contempt proceedings (R. 80-81). These postponements were granted merely because of the pendency of a criminal proceeding involving *some* of the persons under investigation by the Commission (R. 76), and despite the fact that the Commission's investigation could lead to other criminal prosecutions against the same or other persons, civil injunctive proceedings, or even administrative proceedings against persons subject thereto, such as broker-dealers registered under the Securities Exchange Act of 1934 (15 U.S.C. 78). In so doing, the court incorrectly took the position that it had discretion to postpone hearing the application for a contempt order at that time merely because the production of corporate records which the contempt proceedings sought to coerce would be usable in the pending criminal case. The fact that the corporate records might be so used against Young afforded him no basis for refusing to produce the Penfield records in compliance with the district court's order. *Sinclair v. U. S.*, 279 U.S. 263 (1928); *In re Verser-Clay Co.*, 98 F. 2d 859 (C.C.A. 10, 1938), cert. denied 306 U.S. 639; *In re Paramount Publix Corporation*, 82 F. 2d 230 (C.C.A. 2, 1936).

<sup>7</sup> *Endicott-Johnson Corporation v. Perkins*, 317 U.S. 501 (1943); *Penfield Co. of California v. S.E.C.*, *supra*; *Martin Typewriter Co. v. Walling*, 135 F. 2d 918 (C.C.A. 1, 1943).

only by a coercive contempt order—usually imprisonment, as we have shown, unless and until compliance is obtained. Indeed, if contumacious disobedience of a court order enforcing a subpoena issued by the Commission is susceptible of being brushed aside, as has been done in the instant case, the Commission's investigatory powers under the Act would surely be "frittered away in constant delays and failures of enforcement of lawful orders." *Oriel v. Russell*, 278 U.S. 358, 363 (1929).

### CONCLUSION

For the foregoing reasons the order of the court below fining Young \$50 should be reversed, and the court directed to enter an appropriate remedial decree calculated to secure compliance with the order to produce the records in question.

Respectfully submitted,

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January 1946.

No. 11173.

IN THE

# United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

---

SECURITIES AND EXCHANGE COMMISSION,

*Appellants,*

*vs.*

THE PENFIELD COMPANY OF CALIFORNIA

AND ALFRED W. YOUNG,

*Appellees.*

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## REPLY BRIEF.

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PAUL P. O'BRIEN,  
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*vs.*

THE PENFIELD COMPANY OF CALIFORNIA

AND ALFRED W. YOUNG,

*Appellees.*

---

## REPLY BRIEF.

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### Statement of Jurisdiction.

This is an attempted appeal from the judgment of the United States District Court imposing a fine upon Alfred W. Young as Secretary of the Penfield Company of California. The appellant is the Securities and Exchange Commission. Alfred W. Young, appellee, was fined and paid the fine, thus rendering the same moot and exhausting the jurisdiction of the court, but the Securities and Exchange Commission, seeking to review the order of the District Court of the United States for the Southern District of California, Central Division, on July 2, 1945, imposing the now satisfied fine upon the appellee, Alfred W. Young. The attempted jurisdiction of this court is invoked under Section 128 of the Judicial Code as amended (28 U. S. C. 225) (Appellant's Brief, p. 2).

The appellees contend that the order of the District Court imposing the fine which has been paid ended the matter and that the Securities and Exchange Act does not give jurisdiction to this court to review the order of the District Court finding the appellee in contempt as the penalty which the court in its discretion deems appropriate.

Section 22(b) of the Securities Act of 1933 provides as follows:

“In case of contumacy or refusal to obey a subpoena issued to any person, any of the said United States Courts, within the jurisdiction of which said person guilty of contumacy or refusal to obey is found or resides, upon application by the Commission may issue to such person an order requiring such person to appear before the Commission, or one of its examiners designated by it, there to produce documentary evidence if so ordered, or there to give evidence touching the matter in question; *and any failure to obey such order* may be punished by said court as a contempt thereof.”

Section 385 of Title 28 provides the power to punish for contempt. It reads as follows:

“Sec. 385. (Judicial Code, Section 268.) Administration of oaths; contempts. The said courts shall have power to impose and administer all necessary oaths; and to punish, by fine or imprisonment, at the discretion of the court, contempts of their authority. Such power to punish contempts shall not be construed to extend to any cases except the misbehavior of any person in their presence, or so near thereto

as to obstruct the administration of justice, the misbehavior of any of the officers of said courts in their official transactions, and the disobedience or resistance by any such officer, or by any party, juror, witness, or other person to any lawful writ, process, order, rule, decree, or command of the said courts. (R. S., Sec. 725; Mar. 3, 1911, c. 231, Sec. 268, 36 Stat. 1163.)”

Title 28, U. S. C. A., Section 385.

The sole power to punish for contempt both in law and in equity is derived from the above statute.

*Asbestos S. & S. Co. v. Mansville Co.*, 189 Fed. 611;

*Kirk v. Milwaukee etc. Co.*, 26 F. (2d) 501.

At common law, contempt judgments were not reviewable on appeal.

*Bassette v. Conkey Co.*, 194 U. S. 329, 48 L. Ed. 1002.

While the defendant may secure a review of a contempt judgment, we have been unable to find cases where jurisdiction has been taken in a case such as this.

If the court does hold that there is jurisdiction and the court holds further that the appellants' position is tenable, then we ask that the court consider our cross-appeal on the grounds that the evidence is entirely insufficient.

### Statement of Facts.

While the appellant's brief sets forth a statement of facts, much is left untold in the statement, and concerns matters which have been or are before this Court.

On an appeal from the order of the District Court granting the Securities and Exchange Commission's petition for a *subpoena duces tecum*, an application was made to the Circuit Court for a stay of mandate pending an appeal to the U. S. Supreme Court. Counsel for the Securities and Exchange Commission informed the Honorable Judge Denman that if such a stay was granted, their investigation would be frustrated and they would not be able to secure the evidence which they desired in order to complete the investigation. Yet it was only a short time thereafter that the Federal Grand Jury of Los Angeles returned an indictment against the appellees and the individuals named in a matter of some fifty counts, based on the very documents and papers which appellants sought in the *subpoena duces tecum*. [R. 72.]

At the conclusion of a lengthy jury trial, in which all of the possible evidence was produced before the trial court, and many thousands of dollars spent, the defendants were acquitted and the defendants were discharged from custody.

It was thereafter that the Commission came into court and sought the enforcement of an order which, to put it mildly, had become moot in respect to the books and records of the case. The court, finding this defendant guilty of contempt, in view of all the facts before it, not only of which he could and did take judicial knowledge [R. 98], but of all the proceedings had in the present case, fined the defendant \$50.00 for disobedience of the order of

the court. When the court discussed the matter of the disposition of the case, Mr. Cuthbertson, counsel for the Securities and Exchange Commission, said:

“So far as the punishment which the court might see fit to impose, that is up to the court. We are still anxious to get a look at these books and records so I suggest to the court, if he be so disposed, whatever punishment the court might see fit to impose would be in connection with or so long as he refuses to produce his books and records for our inspection.” [R. 86.]

The court replied:

“I do not think I am going to be disposed to do anything like that.

“I sat here for six weeks and listened to books and records. The Government produced people from all over the United States in connection with the Penfield matter.” [R. 86.]

From this order fining Young the Government has appealed, on the contention that this was a civil contempt proceeding and that the court below had *no discretion* but to impose “a remedial, coercive penalty designed to compel compliance with the mandate of this court.” (Appellant’s Brief p. 7.)

The Commisison would substitute its judgment for that of the court and tell the court what order or judgment it should impose in the case, and it has misread the statute.

The statute says:

“In case of contumacy or refusal to obey a subpoena issued to any person,” etc., “. . . and any failure to obey such order of the court may be punished *by said court* as a contempt *thereof*.”

The language of the statute is permissive. It states that a failure to obey the order of the court may be punished *by said court* as a contempt *thereof*. It does not say failure to obey an order of the Commission must be punished by said court as the Commission would have it punished as a contempt of the Commission.

The right to punish for contempt has long been a subject of discussion, but the power to do so or the right to determine the extent of the punishment has not been delegated to any Commission of the United States as yet. Even the power of the court is circumscribed.

*Bridges v. California*, 314 U. S. 252;

*Wilson v. United States*, 26 F. (2d) 214.

It is true, as pointed out in appellant's brief, that there is a distinction between contempt in civil proceedings and criminal contempt. Where, however, the civil contempt is for a disobedience of the court's order, the court in its discretion may impose a judgment for the wrongful conduct or may impose a punitive fine. If the court imposes a punitive fine, it is punitive in the public interest, to vindicate the authority of the court and to deter other like derelictions.

*Ex parte Grossman*, 267 U. S. 87, 69 L. Ed. 527;

*Stewart v. U. S.*, 236 Fed. 838.

Once the fine is imposed, the jurisdiction of the court is at an end.

*In re Bradley*, 318 U. S. 50, 87 L. Ed. 608.

In connection with its seeking the enforcement of the subpoena, the court had power to consider that in a trial covering approximately ten weeks, that the Securities and Exchange Commission had produced before the court, contracts for the bottling of whiskey issued by the Bourbon Sales Corporation, which they had produced by bringing into court all the books and records of the Bourbon Sales Corporation, all of the statements of all of the purchasers (approximately fifty) and the circumstances under which the statements were made, all of the information regarding the value of whiskey owned by the purchasers covered by the bottling contracts, the time within which the whiskey covered by such contracts was to be bottled, the price at which the whiskey was to be sold after it was bottled, the capitalization of the Bourbon Sales Corporation—these were matters for which the members of the staff of the Securities and Exchange Commission said they wanted to investigate the Penfield Company!

The court had before it all the records of the Bourbon Sales Corporation, produced by that company, all salesmen's kits produced by the former President of Penfield Company, a government witness.

See:

*Penfield of California v. Securities & Exch. Com.*, 143 F. (2d) 746.

The court could see before it that practically everything which the Security and Exchange Commission had asked for in its order had already been produced before it by other persons. The only purpose, then, in a finding and adjudication of contempt, was punishment. This the court imposed as it saw fit.

The recent decision in *Parker v. United States*, 153 F. (2d) 66, sustains respondent's contention and theory above set forth.

It holds that in civil contempt there can be no coercive sentence where for any reason the complainant has become "disentitled to the further benefit of the order," because "the complainant is the real party in interest"; also, it held that where a fine is imposed in a civil proceeding "it must not exceed the actual loss to the complainant caused by respondent's violation of the decree."

In the instant case the District Judge made it plain that he did not consider that the complainant had suffered any loss in that behalf and he clearly pointed out that the conditions had so changed that complainant was not entitled to further benefit of the order originally made for its benefit, for the reason that the identical matters directed by said order to be produced, had been secured elsewhere and placed before the grand jury.



### **Cross-Appeal.**

Although we did not file any appeal, the appellees, the Penfield Company of California, and Alfred W. Young, file the following cross-appeal in the event our contentions are not sustained on the main appeal.

The grounds of our cross-appeal are:

#### **I.**

#### **The Court Erred in Holding That the Evidence Was Sufficient to Find the Defendant Guilty of Contempt.**

The sole basis of the contempt order was an affidavit by Charles R. Burr that on January 16, 1945, he addressed and caused to be deposited in the United States Mail a communication to A. W. Young, Secretary-Treasurer of the Penfield Company of California, in the form and content of Exhibit B hereto, advising A. W. Young that your affiant would call at the offices of the Penfield Company on January 24, 1945, for the purpose of examining the books and records referred to in the order dated June 1, 1943. [R. 6.]

On January 24, 1945, when Burr appeared, A. W. Young was out of the city and had been for a month. The record shows that affidavits were filed and before the court. The affidavits were not included in the record by the appellants, but the record shows that both the appellee and his counsel were out of the city at the period of service and that there was no subpoena or any other notice served on Mr. Young, other than in the form of a letter from Mr. Burr. He said he would call, and that is all that he did. [R. 82.]

The court held as follows:

“The Court: The affidavit of the defendant Young indicates that he was absent from the city from January 11 to February 3, so the question now is whether or not his mere absence from the city is sufficient to exculpate him from the order of the Court.

I think that the order is pretty definite, that he should have made the books and records available to Mr. Burr, and even though he were absent from the city I think he should have made some provision so that the examination could have been had, because the order to produce the books and records was made in the alternative, to examine them at their office as an accommodation to the defendant in order to prevent him from having to physically bring the books and papers to the office and interrupt his business. I think the order is definite enough that it should have been obeyed.

The question now is whether or not, as I have indicated, his absence from the city is sufficient to excuse him. I don't believe that it is, Mr. Lavine. I think that he should have provided some means or some person so that they could have been available.”

It is respectfully submitted that a more substantial showing should have been made by the Securities and Exchange Commission and that the showing was not sufficient to warrant the order of contempt.

It has been held that where the proceeding is regarded as criminal in character, the guilt of the accused must be proved beyond a reasonable doubt.

*Michaelson v. U. S.*, 266 U. S. 42, 67 L. Ed. 162;  
*Gompers v. Buck Stove and Range Co.*, 221 U. S.  
418, 55 L. Ed. 797;

*Hoteling v. Superior Court*, 191 Cal. 501.

In any event, a proof of contempt must be clear and convincing and must show a wilful disregard of the court's order.

Since contempt is defined as a "disregard for, or disobedience of the order or command of the court," intent to commit the contempt is usually necessary.

*State ex rel. Webb v. District Court*, 37 Mont.  
191, 95 Pac. 593;

*State v. McGahey*, 12 N. D. 535, 97 N. W. 865;

*Regina v. Payne*, 1 Q. B. 577, 19 English Ruling  
Case 246.

Therefore, since there was no proof in this case of any intent to disregard the order or the request at the time it was made, the proof was entirely insufficient.

It is respectfully submitted, therefore, that the affidavit is entirely insufficient to have found the defendant guilty of contempt, and that the judgment and order finding him guilty of contempt should have been reversed.

Respectfully submitted,

MORRIS LAVINE,

*Attorney for Appellees and Cross-Appellants.*



IN THE  
**United States Circuit Court of Appeals**  
FOR THE NINTH CIRCUIT

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No. 11173

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SECURITIES AND EXCHANGE COMMISSION,  
*Appellant,*  
*v.*

THE PENFIELD COMPANY OF CALIFORNIA and A. W. YOUNG,  
*Appellees.*

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**REPLY BRIEF FOR APPELLANT**

---

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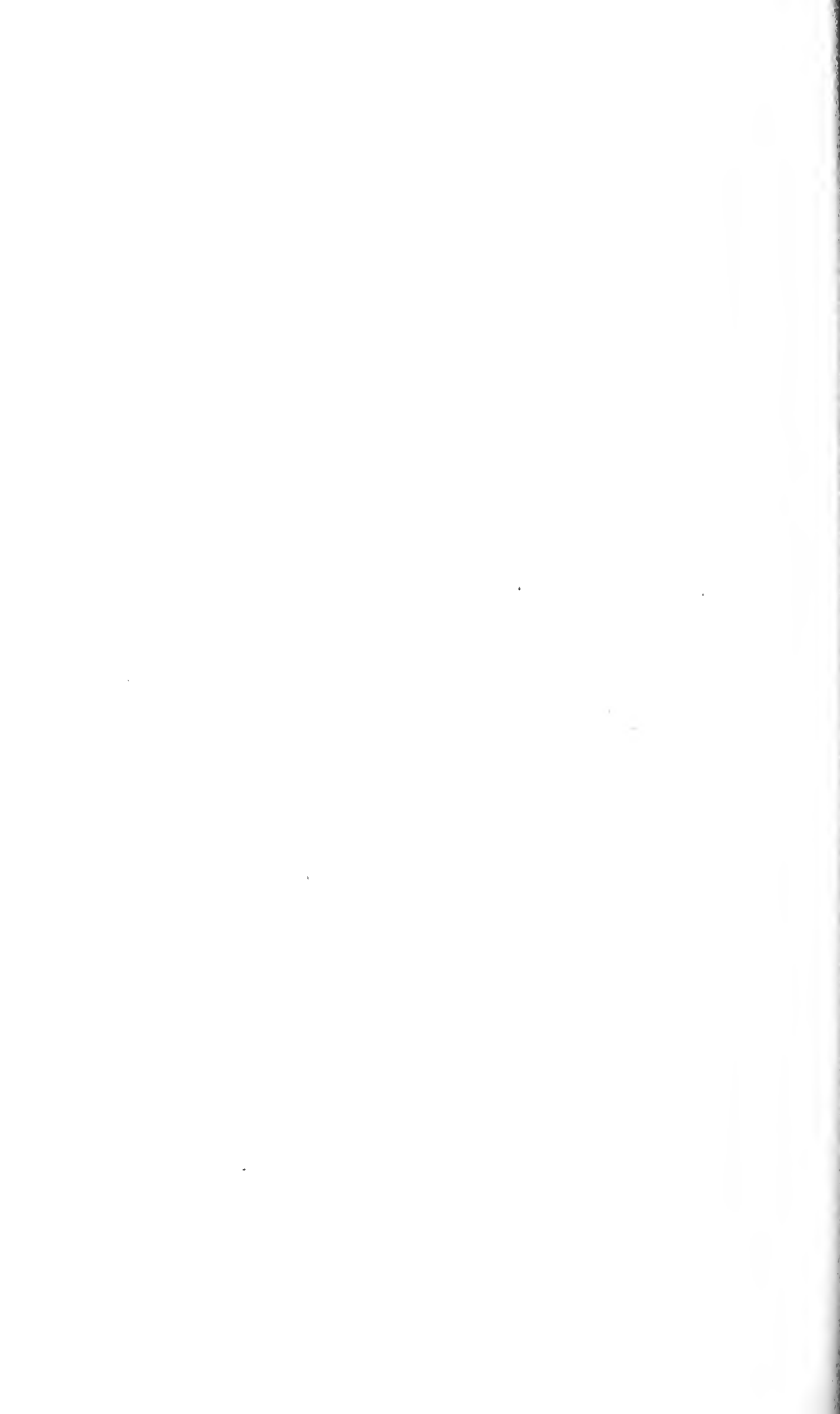
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IN THE  
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**REPLY BRIEF FOR APPELLANT**

The essence of appellees' argument is that the refusal of the court below to enter a coercive decree calculated to enable the Commission to obtain the books and records of Penfield was proper because the court had been apprised in the course of a criminal trial involving these appellees and others (in which the court directed a verdict for some of the defendants, including the appellees) that the Government already had sufficient information as to the affairs of Penfield. Appellees' suggestion that the books covered by the Commission's subpoena were in fact available in the criminal trial is not only contrary to fact and without support in the record, as we shall show below, but inconsistent with appellees' two years' resistance to compliance with the Commission's subpoena. Nevertheless, appellees' argument

underlines and confirms what we understand to be the basic error underlying the decision of the court below, namely, the assumption that a district court has discretion to deny enforcement of the Commission's subpoena notwithstanding a prior enforcement order and the affirmance of that order on appeal. That the court lacked discretion to deny the Commission an effective enforcement decree appears not only from the authorities cited in our main brief but from *Parker v. United States*, 153 F. 2d 66 (C.C.A. 1, 1946), cited by appellees (Br. p. 8). That case fully sustains our position that the court below had no discretion under the circumstances but to issue a coercive decree. In that case the court order which had been disobeyed was an order to pay over a sum of money. Upon non-payment the contemnor was ordered committed until payment was made. The court said at page 70:

“Proceedings in civil contempt are between the original parties and are instituted and tried as a part of the main cause. Though such proceedings are ‘nominally those of contempt’ (*Worden v. Searls*, 1887, 121 U.S. 14, 26, 7 S. Ct. 814, 820, 30 L. Ed. 853), the real purpose of the court order is purely remedial—to coerce obedience to a decree passed in complainant's favor, or to compensate complainant for loss caused by respondent's disobedience of such a decree. If imprisonment is imposed in civil contempt proceedings, it cannot be for a definite term. *Gompers v. Bucks Stove & Range Co.*, supra, 221 U.S. at pages 442-444, 31 S. Ct. 492, 55 L. Ed. 797, 34 L.R.A., N.S., 874; *In re Kahn*, 2 Cir., 1913, 204 F. 581. *The respondent can only be imprisoned to compel his obedience to a decree. If he complies, or shows that compliance is impossible, he must be released, for his confinement is not as punishment for an offense of a public nature. If a compensatory fine is imposed, the purpose again is remedial, to make reparation to a complainant injured by respondent's disobedience of a court decree. While respondent may be confined to coerce payment of the compensatory fine, he must be released if he pays the fine or shows his utter inability to do so—confinement beyond that point*

would be punitive, not remedial. If complainant makes a showing that respondent has disobeyed a decree in complainant's favor and that damages have resulted to complainant thereby, complainant is entitled as of right to an order in civil contempt imposing a compensatory fine. *Union Tool Co. v. Wilson*, 1922, 259 U.S. 107, 42 S. Ct. 427, 66 L. Ed. 848; *Enoch Morgan's Sons Co. v. Gibson*, 8 Cir., 1903, 122 F. 420, 423; *L. E. Waterman Co. v. Standard Drug Co.*, 6 Cir., 1913, 202 F. 167. *The court has no discretion to withhold the appropriate remedial order.* In this respect the situation is unlike that of criminal contempt where the court in its discretion may withhold punishment for the past act of disobedience." (Italics supplied.)

Appellees' contention that "the power to punish for contempt" is completely within the discretion of the district court and not reviewable by the complainant (Brief pp. 2-3, 6)—whatever its merit as applicable to criminal contempt—has absolutely no bearing on the issues presented in a civil contempt proceeding instituted by the Commission. Appellees' argument would make a mockery of the processes of review by an appellate court of a district court order in any proceeding designed to compel action by a defendant, since even a reversal of a district court order refusing the relief sought by the complainant would be nugatory if it were then left to the discretion of the district court whether to use its coercive process to require compliance with the order.

Even if the court had discretion to reconsider, in the light of the developments at the criminal trial, the right of the Commission to enforcement of its subpoena, we submit that there is a complete absence of support for such a reconsideration in Young's response to the order to show cause why he should not be adjudged in contempt (R. 77, 83). Nor is there any support therefor in the following colloquy between counsel and court (R. 86-7), which sets forth the only reasons given by the court below for not now enforcing the subpoena. That colloquy, which is set forth

in the margin,<sup>1</sup> reflects only an impression that "during one period of time this defendant [Young] had nothing whatsoever to do with the Penfield Company." Assuming the correctness of that observation, it would have absolutely no bearing upon Young's obligation as an officer of Penfield to produce the books of Penfield. Nor would it, of course, negative the possibility that upon obtaining access to Penfield's books further evidence would be revealed as to possible violations of law by Young as well as others.

At no point in the proceedings below did counsel for appellees make any claim that the records in question had been produced before the grand jury or in the trial of the criminal case.<sup>2</sup> Moreover, the statement of Assistant United

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<sup>1</sup> Mr. Cuthbertson: So far as the punishment which the Court might see fit to impose, that is up to the Court. We are still anxious to get a look at these books and records, so I suggest to the Court, if he be so disposed, whatever punishment the Court might see fit to impose would be in connection with or so long as he refuses to produce his books and records for our inspection.

The Court: I don't think that I am going to be disposed to do anything like that. I sat here for six weeks and listened to books and records. The Government produced people from all over the United States in connection with the Penfield matter.

Mr. Cuthbertson: I might say, your Honor, that we have in mind that these books and records may disclose certain acts other than those charged in the indictment. We don't propose to go over the same matter that the Court went over in connection with the criminal case.

The Court: The Court can take judicial notice of its own books and records, and in that trial the evidence was clear and definite and positive from all of the Government's witnesses, that during one period of time this defendant [Young] had nothing whatsoever to do with the Penfield Company. Whether that period of time is covered by what the Securities and Exchange Commission seeks or not, I don't know.

<sup>2</sup> There was no challenge to the statement of counsel for the Commission, made after the court below granted Young's motion to quash the grand jury subpoena of Penfield's records, that "There is not in this record one scintilla of evidence by affidavit or any other form from the mouth of Mr. Young [appellee] . . . why he has not complied with your Honor's order" (R. 51).

States Attorney Bell (who was representing the Government in connection with the attempt to enforce the grand jury subpoena) makes it clear that the United States Attorney and the grand jury had been unable to secure these records from appellees.<sup>3</sup>

In connection with appellees' comment regarding the Commission's application to this Court in the summer of 1944 to vacate the stay pending certiorari, it should be noted that the aforementioned statement of the Assistant United States Attorney verifies the fact that the Commission found it necessary to submit to the United States Attorney the results of an uncompleted investigation. The lack of the books and records of Penfield (R. 12-15), (to be distinguished from the records of the affiliated Bourbon company referred to by appellees (Br. p. 7)), may also be the reason for the gap in the evidence which in the opinion of the court below justified his granting of a motion for directed verdict of acquittal in the criminal case. Appellees obliquely give the impression (Brief, p. 4) that the Commission sought enforcement of the order of the district court only after the criminal trial was over. The record clearly shows the contrary.<sup>4</sup>

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<sup>3</sup> Mr. Bell: "In view of the fact that you have mentioned the criminal matter, I would like to say just one thing, namely, that, as I indicated during my own discussion, the investigation of the Grand Jury up to that time indicated there was quite a number of other defendants as to whom proof or evidence was inconclusive, showing that in their minds they needed additional evidence. Now, that evidence, one way or the other, whether it would or would not incriminate them, may be found in the books of the Penfield Company of California" (R. 75). Moreover, in harmony with the foregoing are counsel for appellees' repeated references to the records of Penfield as being "sought" (R. 33, 68).

<sup>4</sup> After the mandate of this Court came down (December 7, 1944) the Commission notified appellees and their counsel that it was still seeking access to said books and records, and upon refusal thereof the Commission, on January 24, 1945, sought a coercive contempt decree (R. 80-81). The delay in hearing the contempt application resulted from the exercise

Appellees have also sought to convey the impression that the contempt proceeding was mooted by the disposition of the criminal case referred to by appellees. It is clear that the latter case by no means fully comprehended the various objectives of the Commission's investigation, which is still uncompleted. Until the books in question are examined it will be impossible to determine what remedies—civil, administrative, or even criminal—are still open. In any case, it certainly comes with ill grace from appellees, whose contumacious disobedience has caused the delay, to urge the possible fruitlessness of an examination of the books in question. On the contrary, it would seem that appellees' effort to profit from their own disobedience of the district court's order should emphasize the desirability of affording the Commission full scope in examining the records in question in furtherance of its investigation. A coercive decree for this purpose will by the same token make it manifest that orders of the courts cannot be flouted with impunity.

There is no merit to the "cross appeal" of appellees. They have no standing to appeal from the finding of contempt.<sup>5</sup> Moreover, the record clearly establishes that appellees were under a continuing obligation to produce the books and records in question from the time that this Court's mandate was spread on the records of the district

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by the court below of an assumed discretion to defer hearing of the contempt case on the merits until after the trial of the criminal case because of the objection of appellees that the records of the Penfield Company were being sought for use against them in the criminal case. As we have noted in our main brief (p. 9), that the records might have been so used afforded no justification for refusing to hear the contempt case on the merits with a view to enforcing the order of the court, and thereby upholding the respect to which judicial orders are entitled.

<sup>5</sup> Appellees filed no timely notice of appeal in the district court and therefore lost their right to appeal. *Fiske v. Wallace*, 115 F. 2d 1003 (C.C.A. 8, 1940), cert. denied 314 U.S. 663; *United Drug Co. v. Helvering*, 108 F. 2d 637, 639 (C.C.A. 2, 1940). Furthermore by paying the fine of \$50 they acquiesced in the finding of contempt.

court, December 7, 1944 (R. 5, 80). Appellees and their counsel were obviously aware of the affirmance by this Court and the denial of their petition for certiorari. The record also shows that appellees and all of their counsel were given specific notice in writing that the Commission was still seeking the books and records in pursuance of the order of the district court (R. 9-10, 80). Appellees' counsel were present in the court below on several occasions in connection with the contempt proceedings and were put on notice of the demand for the books and records. Nevertheless, appellees have never tendered the books, but instead have persistently resisted their production.

Respectfully submitted,

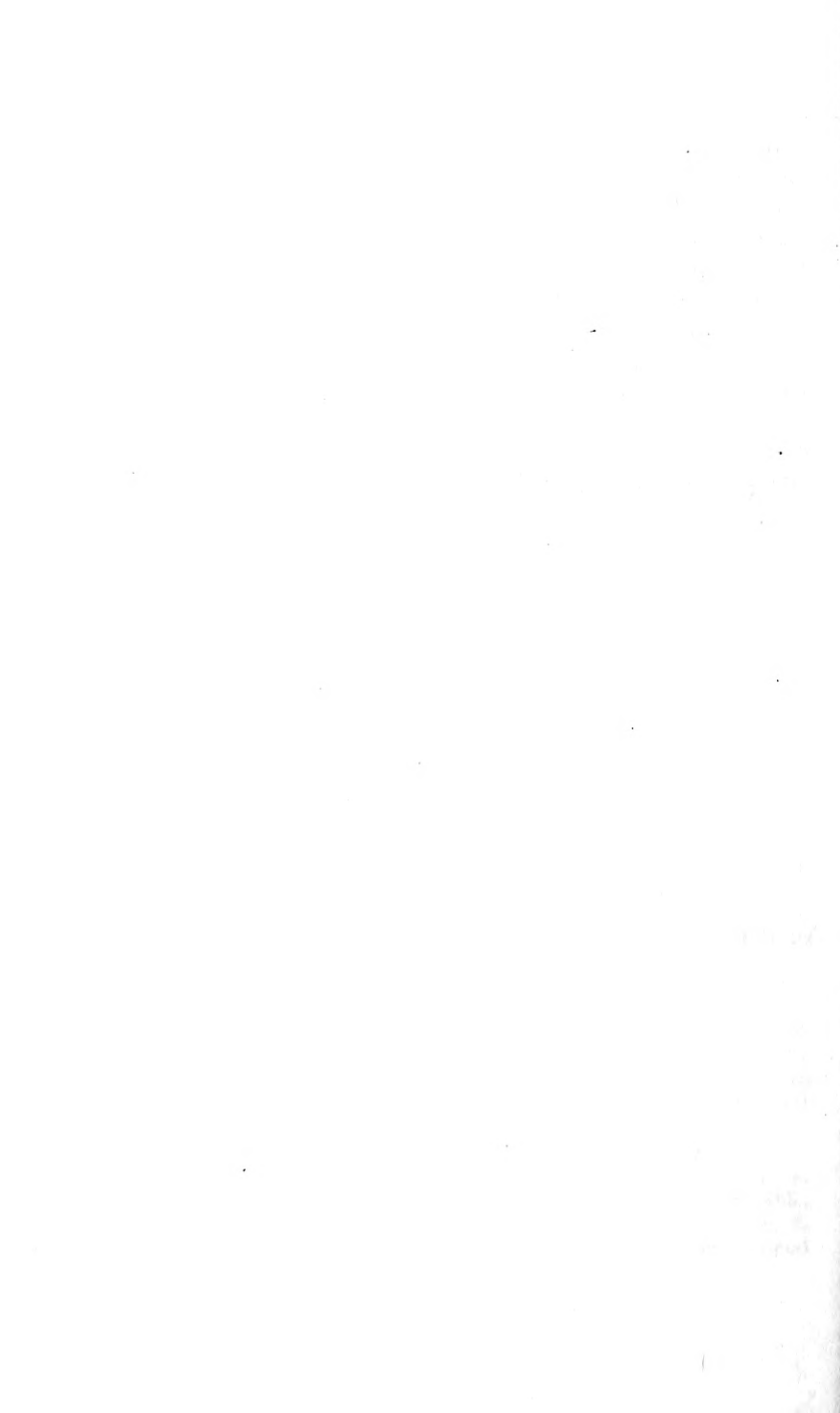
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April 1946.





No. 11180.

IN THE

# United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

HARRY LUTZ and HARRY LUTZ and ROSE LUTZ, as executor and executrix of the last will and testament of Abe Lutz, Deceased,

*Appellants,*

*vs.*

NEW ENGLAND MUTUAL LIFE INSURANCE COMPANY OF BOSTON, a corporation,

*Appellee.*

## APPELLANTS' OPENING BRIEF.

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No. 11180.

IN THE

# United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

---

HARRY LUTZ and HARRY LUTZ and ROSE LUTZ, as executor and executrix of the last will and testament of Abe Lutz, Deceased,

*Appellants,*

*vs.*

NEW ENGLAND MUTUAL LIFE INSURANCE COMPANY OF BOSTON, a corporation,

*Appellee.*

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## APPELLANTS' OPENING BRIEF.

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### Jurisdiction.

This is an appeal by the defendant Harry Lutz from a judgment of the United States District Court for the Southern District of California, Central Division [I, 62] declaring a policy of life insurance issued by plaintiff (Appellee) to be void [I, 60], and formally cancelling and rescinding the policy [I, 62].

This appeal presents no question of jurisdiction of either this or the trial court. Appellee is a Massachusetts corporation; defendant is a resident of the County of Los Angeles, State of California, and the amount in controversy

exceeds the sum of \$3,000.00, exclusive of interest and costs. The suit was brought by appellee under Section 41, U. S. C. A. (Judicial Code, section 24, amended).

Appellant filed an answer and counterclaim to which answer was interposed by Appellee. The case was tried before Judge Ralph E. Jenney, now deceased, whose opinion was rendered on May 4, 1945 [I, 352], and the judgment appealed from was entered on June 14, 1945 [I, 62]. The notice of appeal was filed on August 28, 1945 [I, 66].

### Statement of the Case.

On December 1, 1942 [II, 384], upon the written application of the Appellant, the Appellee Insurance Company issued, and on or about December 9, 1942 [II, 384], delivered its policy of life insurance No. 1,172,844 on the life of another, to-wit, Appellant's 64 year old father, Abe Lutz, who is referred to in the policy as the "insured," insuring the life of the *assured's* (Appellant's) said father for the policy face amount of \$13,000 and naming the *assured* Appellant, "applicant" therefor, the "beneficiary" and "the sole owner" of the policy which was made effective, and antedated, as of October 13, 1942.

By this appeal, Appellant seeks a review of the judgment in favor of the Appellee insurer on its complaint filed after the death of the "insured," for cancellation and rescission of the policy, notice of which was also given after the loss occurred. The Appellee insurer's complaint, as amended, alleged [I, 2], that the trial court found [I, 49], the policy void and formally cancelled and rescinded [I, 62] the same on the premise that the "insured" misrepresented and concealed facts concerning his health and



medical history which were material to the risk insured against; that the Appellee relied thereon and was misled to its prejudice thereby, and that the “insured” was not in that state of health prerequisite to the policy’s validity when the application therefor was approved and the first premium thereon was paid.

There is no claim or allegation in said complaint, no evidence offered to support and no finding made that the *assured* Appellant, the “applicant” for, “beneficiary” and “sole owner” of the policy, was a party to such, or any, alleged concealment or misrepresentation.

On November 14, 1942, Appellant, as the “applicant for insurance,” and his now deceased father, Abe Lutz, as the consenting “proposed insured,” signed the application which is identified as “Part I” and which contained no part of the alleged concealment or misrepresentations upon which said complaint, findings and judgment are premised. Appellant signed no other application or document other than said “Part I” [II, 405].

Two days later, on November 16, 1942, Appellant’s 64 year old father submitted himself to a physical examination by Appellee’s medical examiner [Finding V] who thereafter made his report to Appellee company [Ex. 27, II, 408a]. Appellant’s said father orally answered the printed questions with respect to his medical history in the separate document entitled “Part II” [II, 406] as said medical examiner propounded *his interpretation of them* to Appellant’s said parent, and, after said medical examiner in his own longhand wrote *his interpretation of the answers* thereto of the “insured,” in the blanks, after the printed questions. Appellant’s father *alone* signed said

“Part II” at the bottom thereof above a provision therein whereby Appellant’s father did

“\* \* \* expressly waive \* \* \* all provisions of law forbidding any physician or other person who has attended or examined me, or who may hereafter attend or examine me, from disclosing any knowledge or information which he thereby acquired, and I authorize any such disclosure.” [Ex. 27, II, 406.]

Said waiver of and authorization for such full disclosure executed by Appellant’s father is hereinafter referred to as the “insured’s waiver of privilege and authorization for full disclosure.”

Before the “insured” signed “Part II,” the medical examiner wrote therein as the answer of Appellant’s father to

- Question 28:* that the “insured” had been declined for insurance a few years before by Equitable Life;
- Question 37:* that the “insured” had been suspected of having sugar or albumen in his urine;
- Question 32:* that the insured’s weight had decreased about 15 pounds in the last two years;
- Question 33:* that the insured’s present weight had been maintained only about 3 months;
- Question 36:* that the “insured” had consulted and been physically examined by Dr. Maurice H. Rosenfeld of 1908 Wilshire Boulevard during the then preceding August, 1942.

At the same time, on November 16, 1942, when the “insured” and the only signer of “Part II,” affixed his signature to “Part II” below the “insured’s waiver of

privilege and authorization for full disclosure," the medical examiner knew that:

(a) During the physical examination referred to in "Question 36," *supra*, Dr. Maurice H. Rosenfeld checked the insured's heart [I, 218];

(b) the "insured" had a history of diabetes [I, 216];

(c) the "insured" had been rejected for insurance on account of sugar in his urine [I, 216];

(d) he, the medical examiner, had examined the "insured" several times before [I, 216].

On November 27, 1942, three days before the policy in suit was issued and 12 days before its delivery, Appellee was advised on receipt of a letter from the medical director of the Equitable Life Assurance Society [Ex. 27, II, 411-412] that:

(a) the "insured," in addition to Dr. Maurice H. Rosenfeld named by the "insured" in "Part II," had also been attended by Dr. Lissner who was not named or mentioned by the "insured" in said "Part II";

(b) Equitable refused to issue additional insurance on the life of the "insured" [Ex. 27, II. 412].

When the policy in suit was issued [II, 384] and over one week before it was delivered [II, 384], the Appellee knew that it did not have, was on notice and inquiry [II, 432] of Messrs. Hays & Bradstreet at 609 South Grand Avenue, Los Angeles, California, Appellee's "general agents" [I, 271], to secure:

(a) "a complete detailed statement from Dr. Rosenfeld and Dr. Lisner";

(b) "full details" with respect to:

1. "why were the doctors consulted"?
2. "what were the symptoms"?

3. "what were the findings"?
4. "what treatment or advice was given"?
5. "what were the results"? [Ex. D; II. 432].

Pursuant to Appellee's inquiry [Ex. D; II, 432] to its "general agents" [I, 271] in Los Angeles for "full details" with respect to "why" Doctors Rosenfeld and Lissner were consulted, what treatment or advice was given and what the symptoms, findings and results were, Mr. Harold Morgan, the brokerage manager [I, 310] of Appellee's said general agents, did not talk to Dr. Rosenfeld [I, 147] and it appears that he may have satisfied himself by merely talking to Dr. Rosenfeld's bookkeeper on the telephone inasmuch as Mr. Morgan in his own longhand [I, 328-330] wrote on Appellee's letter [Ex. D; II, 432] of inquiry the following:

"EX 1369"

which was Dr. Rosenfeld's telephone number [I, 146];

"Miss Byington"

which was Dr. Rosenfeld's bookkeeper [I, 146];

"Because of requirements of Equitable for  
B. L. S. U."

which referred to blood sugar [I, 329] in response to the inquiry as to why the doctors were consulted;

"None"

[I, 329; II, 432] opposite: what were the symptoms;

"Neg"

[I, 330; II, 432] opposite: what were the findings;

"None"

[I, 330; II, 432] opposite: what treatment or advice was given; and

"Satisfactory"

[I, 330; II, 432] opposite: what were the results.

Automatically, as a custom, usage and routine, Appellee's "general agents" request a retail credit inspection on applications which are submitted to Appellee [I, 343], but in this instance the services of the Retail Credit Company's insurance inspector and investigator, Mr. Paul M. Arnold, were not employed by Appellee until the last week in June, 1944 [I, 238], approximately 30 days after Appellant's father died (May 28, 1944). The investigator, Mr. Brown, as the first step in his investigation, contacted Dr. Rosenfeld [I, 239] who answered all questions with respect to the "insured's" health and condition [I, 240].

Appellee is a member of the Medical Information Bureau of Cambridge, Massachusetts [I, 283], also known as "MIB" [I, 299], and during the months of November or December, 1942, obtained therefrom information "in code" [I, 283] concerning the "insured" which Appellee destroyed and was unable to produce at the time of trial [I, 284]. In January and March, 1943, and prior to the death of the "insured," Appellee received two other M.I.B. "confidential reports" with respect to the deceased [I, 298] which were not produced in court but which contained "confidential" information of such character as to cause Appellee "to refuse to proceed further" with the additional insurance [I, 298] requested concurrently [Ex. D; II, 426] with the application upon which the policy in suit was issued.

Before Appellee issued the policy in suit it made no investigation of the "insured's" previous insurance record [I, 286]. The reasons which prompted Appellee to *take a chance* without complete investigation, and issue the policy, notwithstanding the fact that Appellee was put

on notice and active inquiry [II, 432] of its "general agents" in Los Angeles [I, 271], is explained frankly, as a "risk" [I, 293] consciously taken and embraced by Appellee where the face amount of the policy is "under \$15,000" to avoid "expense" and "delay in issuing policies" [I, 293], by Appellee's medical director [I, 247], Harold M. Frost, M.D. [I, 246], who approved [I, 255] the application for the policy in suit, as follows:

"The reason for requesting detailed statements from Doctors Rosenfeld and Lissner arises from the fact that Medical Directors have learned from unfortunate experience that the statements of applicants as to their consultations with physicians must be evaluated with caution. Medical Directors are convinced that the average individual intends to be honest. However, we have learned that some applicants apparently attempt to conceal damaging information; that others have not understood the information as to their condition given them by their physicians and therefore have not considered it significant; that others have actually not been advised by their physicians as to the significance of serious signs or symptoms which the physician had discovered. Not infrequently a statement from the physician will prove that what appeared an insignificant consultation, from the information given by the applicant in his answers to questions in Part II of his application, was actually a serious matter, the physician having discovered signs and symptoms which would forbid issuance of life insurance at standard rates and might necessitate its issuance at substandard rates, or might necessitate rejection of the risk.

“As a practical procedure, considerations of expense in obtaining such statements, for which the physicians must be paid by the company, and the delay in issuing policies as a consequence of requesting such statements influence the Medical Director in formulating his policy as to how frequently and in what types of cases a physician’s statement will be required.

“In the case of applications for large amounts of insurance, a routine requesting of physician’s statements is necessary for the protection of the company as large amounts are at risk. As for small applications, amounts under \$15,000, within which range the great majority of applications fall, the routine requests are neither practical nor feasible because of excessive expense and undue delay in issuing policies.

“The only practical policy as respects applications for small amounts of insurance is to request physicians’ statements only when the applicant in his statements as to his medical history raises definite doubt as to his insurability. Further, it is common knowledge among medical directors that applicants at the older insurance ages, the late fifties and the sixties, must be scrutinized much more carefully as to medical history and condition of health than in the case of applicants of younger ages. Companies generally do not issue to older applicants as much insurance as to younger applicants, because in general the older applicants are not as good physical ratings as the younger applicants.

“In the case of Mr. Lutz, when I reviewed his application I noted that he was in his sixty-fifth year,

a definitely advanced insurance age. He applied for \$13,000 of insurance. At the same time a request was made for an additional \$13,000 of insurance. For a man as old as Mr. Lutz, \$13,000 of insurance would be considered only a moderate amount to be issued by a company the size of the New England Mutual Life Insurance Company, while \$26,000 of insurance would be considered a large amount to be retained by such a company.

“As I had no reason to doubt the accuracy of the statements of Mr. Lutz as to his medical history, I, depending upon his honesty, believed that I could safely approve his application for \$13,000 of insurance without asking for statements from Doctors Rosenfeld and Lissner. His physical examination was satisfactory, and I had no other information of an unfavorable nature as respects his medical history or health. I therefore approved his application for \$13,000.

“I believed, however, that, in view of his advanced insurance age, that for his age the amount of \$26,000 life insurance was a large amount to be issued by my company, and the fact that he had admitted consulting Dr. Rosenfeld, and to my knowledge had consulted Dr. Lissner, that it would be advisable to request the detailed statement as recited in [Ex. D; II, 432], whereupon this statement was requested.” [I, 292-295.]

Appellant in his application (“Part I”), agreed that “this application, including Part II, a copy of which shall be attached to the Policy when issued, shall become a part



of every Policy issued hereon" [Ex. 27; II, 405]. The policy in suit provides that said "Part I" and "Part II," which includes the "insured's waiver of privilege and authorization for full disclosure," are incorporated in and expressly made a part of the insurance contract [Ex. 3].

The policy was delivered to Appellant [Finding VI], "the sole owner" [Ex. 3] and "beneficiary" appointed "without right of revocation by the insured" [Ex. 3]. Appellant paid Appellee all premiums required to be paid [Finding XX and XXV] *i. e.*, two annual payments.

The "insured" died May 28, 1944 [Finding VIII], one year, 7 months and 15 days after the effective date of the policy, and the Appellee filed its original complaint on October 11, 1944, and the amended complaint [I, 2], which added paragraph XVI [I, 14-15] thereof (alleging that at the date of Appellee's approval of the application, and issuance of the policy in suit and receipt of the payment of the first premium thereon, Appellant's father (the "insured") was suffering from heart trouble, dizziness, fainting spells, palpitation of the heart, shortness of breath, pain and pressure in the chest, nausea, indigestion, and various other ailments), was filed January 31, 1945 [I, 21] *i. e.*, over two years after date [Ex. 3], issuance [Ex. 1; II, 384] and delivery [Ex. 1; II, 384] of the policy [Ex. 3] which was incontestable after it had "been in force for a period of two years from its date of issue." [Ex. 3].

### Specification of Errors.

Appellant's concise statement of points on appeal is printed in the appendix hereto. Summarized, the errors relied upon in this appeal are that:

(1) The trial court erred in denying Appellant's motion to dismiss [I, 195];

(2) The trial court erred in admitting, over Appellant's objection, testimony of the insured's attending physician relating to the health and physical condition of the insured [I, 99-100];

(3) The trial court erred in decreeing rescission and cancellation of the policy for concealment and fraud, attributed to the "insured", with respect to his health and medical history [I, 60-63];

(4) The trial court erred in failing to find that Appellee:

(a) Waived its right:

(1) To complain of concealment or fraud;

(2) To claim the insured was not in good health when the policy was delivered;

(b) Was estopped:

(1) To deny liability on the ground of fraud or concealment;

(2) To claim that the "insured" was not in good health when the policy was delivered.

(5) The trial court erred in

*Finding V*; in finding that:

(1) Appellee's medical examiner accurately recorded:

(a) the insured's answers to questions contained in "Part I" or "Part II";

(b) the insured's answers to Appellee's medical examiner's interpretation of said questions;

(2) The insured's answers were a part of said application, *i. e.*, "Part I";

(3) The insured read said application [I, 50-51; Finding V].

*Finding IX*; in finding that:

(1) The insured in "said application" ("Part I") or in "Part II" represented to Appellee that the insured had "never" suffered from indigestion, dizziness or fainting spells, palpitation of the heart, or pain or pressure in the chest;

(2) The insured *ever* suffered from "indigestion", "fainting spells", or "pain in the chest" [I, 52; Finding IX].

*Finding XI*; in finding that:

(1) The insured, within 5 years prior to the date of either "Part I" or "Part II", had consulted or been treated "by physicians for dizziness or fainting spells";

(2) The insured had ever been told unequivocally that he was suffering from angina pectoris;

(3) The insured's physician ever prescribed medicine to relieve pain in the "chest";

(4) The insured ever suffered pain in the "chest" for any cause or reason whatsoever;

(5) The matters in subdivisions (1), (2), (3) and (4) immediately above mentioned were concealed or undisclosed in "Part II" [I, 52-53; Finding XI].

*Finding XII*; in finding that:

The matters found in Findings IX and XI with respect to which it is hereinabove urged that the court erred, were known to the insured when he signed "Part II" [I, 53; Finding XII].

*Finding XIV*; in finding that:

The insured had knowledge of the terms or provisions of the policy in suit [I, 54; Finding XIV].

*Finding XV*; in finding that:

Prior to the insured's death, Appellee had no knowledge, information or notice that the insured had failed to disclose the fact that he had theretofore consulted or been examined by physicians other than Dr. Rosenfeld [I, 54; Finding XV].

*Finding XIX*; in finding that:

(1) Said insured was not in good health at the time said policy was delivered, or the first premium thereon was paid;

(2) Said insured knew he was not in good health or was suffering from angina pectoris at the time said application was signed or delivered or at the time said policy was issued or delivered, or at the time the first premium thereon was paid [I, 56; Finding XIX].

*Finding XXI*; in finding that:

(1) At the time "Part I" or "Part II" was signed, said insured knew:

(a) the contents thereof;

(b) the answers to the questions therein contained concerning the insured's health or medical history were not true;

(c) matters of fact concerning the insured's health or medical history were concealed or misrepresented in or by "Part I" or "Part II";

(2) The insured did not correctly or truly answer all or any questions asked him by the Appellee's medical examiner or by Appellee's agent who filled in the application [I, 57; Finding XXI].

*Finding XXII*; in finding that:

(1) Said insured did not furnish Appellee's agents or representatives with true or correct information

on all or any matters as to which information was requested by said agents or representatives;

(2) Said insured did misrepresent or conceal matters of fact concerning which the insured was interrogated [I, 57; Finding XXII].

*Finding XXIII*; in finding that:

(1) Appellee, or its representatives who contacted the office of the insured's physician, did not have the opportunity of obtaining full, true or correct information from such physician regarding the physical condition or health of said insured;

(2) Appellee did not have ample opportunity to ascertain the true facts concerning the health or medical history of said insured prior to the death of said insured;

(3) Appellee is not estopped to rescind or cancel said policy or to refuse payment of the proceeds thereof;

(4) Appellee is not precluded from relief by reason of its delay;

(5) Appellee rescinded said policy promptly upon discovery of the facts which it now claims were concealed from it [I, 57-58; Finding XXIII].

*Finding XXIV*; in finding that:

(1) Appellee did not have the opportunity of obtaining any information from the physician of the insured regarding the latter's physical condition or health;

(2) At the time of signing "Part II," the insured did not inform Appellee's medical examiner that Dr. Maurice H. Rosenfeld had given the insured a complete physical examination [I, 58-59; Finding XXIV].

(6) The trial court erred in its

*Conclusion I*, that: Appellee is entitled to judgment cancelling and rescinding the policy and

declaring it void, and requiring that the original be delivered to Appellee for cancellation [I, 60; Conclusion I].

*Conclusion II*, that: Appellee is entitled to judgment declaring that Appellant has no rights and Appellee has no duties, liabilities or obligations under the policy except that Appellant is entitled to recover from Appellee only \$2,523.43 as restoration to him of all premiums and considerations by him paid to Appellee [I, 60; Conclusion II].

*Conclusion III*, that: The policy failed to become effective because the insured was not and knew he was not in good health when the application was approved, the first premium paid and the policy delivered [I, 60; Conclusion III].

*Conclusion IV*, that: Appellee promptly rescinded and was entitled to rescind the policy by reason of misrepresentation or concealment of facts, known to the insured or material to the risk, which the insured ought to have communicated or disclosed in the application [I, 61; Conclusion IV].

*Conclusion V*, that: Appellee has not waived and is not estopped to assert its right to rescind the policy [I, 61; Conclusion V].

*Conclusion VI*, that: The matters alleged in Appellee's amendment to its original complaint (Paragraph XVI of the Amended Complaint) is not barred by the incontestable clause in the policy [I, 61; Conclusion VI].

*Conclusion VII*, that: Appellant take nothing by his counterclaim filed herein [I, 61; Conclusion VII].

## ARGUMENT.

### Summary.

### POINT I.

**The Appellee Insurer Cannot Repudiate the Policy, Deny All Liability Thereunder, and at the Same Time be Permitted to Stand on, Exercise Rights Under, and be Permitted to Enjoy the Benefits of a Provision Inserted in the Policy for Its Benefit.**

It is Appellant's position: that after the "insured's" waiver of privilege and authorization for full disclosure," contained in the document known as "Part II," was merged into and by the terms of the policy itself was expressly made a part thereof, the Appellee insurer's *subsequent* exercise of its power to elicit testimony from the "insured's" attending physicians (disclosing upon the trial of this case, over Appellant's objection, information relating to the medical history, health and physical condition of the "insured") was an exercise of a right accruing to Appellee under the policy or contract of insurance, the exercise of which was inconsistent with Appellee's position that the contract of insurance, the policy, was void; That Appellee cannot repudiate the policy, declare it void, and support its prayer for cancellation and rescission of the insurance contract, by standing on a provision in that contract empowering it to elicit from the deceased "insured's" attending physicians privileged communications acquired by them to enable them to prescribe

treatment for the “insured.” This subject matter is treated in the argument under the following headings:

(a) The Parties to the Insurance Contract;

(b) The Policy, Including “Part I” and “Part II,” Does Not Provide, Either Expressly or by Implication, That Appellant’s Rights Are Predicated Upon the Conduct of the “Insured”;

(c) Neither Appellant Nor the Heirs or Personal Representatives of the Deceased “Insured” Could Waive the Latter’s Privilege With Respect to Confidential Communications to His Attending Physicians to Enable Them to Prescribe Treatment for Him;

(d) After the Policy Was Issued, the “Insured’s” Waiver of Privilege Was an Integral Part of and Provision in the Policy for the Appellee’s Benefit, and Its Rights and Powers Thereunder May Not Be Exercised and Enjoyed by It Concurrently With Its Affirmative Repudiation of and Prayer for Cancellation and Rescission of the Contract in Its Entirety;

(e) The Trial Court Erred in Admitting the Testimony of the Deceased “Insured’s” Attending Physicians Over Appellant’s Objections. In the Absence of Such Testimony, There Is No Evidence in Support of the Judgment.



## POINT II.

### The Appellee Is Precluded by Waiver and Estoppel.

It is Appellant's position: that his father, the "insured," gave true and correct answers to Appellant's medical examiner; that any erroneous answers, all written by and in the long hand of Appellee's medical examiner, to the printed questions in "Part II," were the result of and occasioned by said medical examiner's misapprehension of either the printed question in "Part II," or the answer thereto made by the *illiterate* "insured"; that the "insured's" vindication of fraud, misrepresentation, concealment and intention thereof, is established beyond cavil by his having given Appellee, in "Part II," the name and address of his attending physician, Dr. Maurice H. Rosenfeld, waived all privilege and affirmatively authorized all physicians or other persons who had attended or examined him to fully disclose to Appellee all knowledge and information, including the information which, after the "insured's" death, Appellee did secure, and proved in open court as the only evidence which appellee had or produced in support of the allegations in its complaint herein; that Appellee waived its right to the information which it claims was concealed from it, and is estopped to assert that it was misled or defrauded, inasmuch as Appellee was given the name and address of the attending physician of the insured and authority to elicit a full disclosure from said physician of precisely the same facts which after the death of the "insured" were introduced in evidence through the testimony of said attending physician

in support of Appellee's action to declare the policy void, and inasmuch as Appellee did get in touch with the office of said physician through its local general agent, and thereafter waited until it had received two annual premiums from Appellant and thereafter waited until Appellant's father, the "insured," died before it elected to and did communicate with said physician, from whom Appellee then readily elicited a complete and full disclosure. This is disclosed under the headings:

(f) All Answers to the Printed Questions in Part II of the Application Are Written by and in the Longhand of the Medical Examiner and Represent His Interpretation of That Which He Considered the Material Portion of the Insured's Answers to the Medical Examiner's, in One Instance, At Least, Admittedly Erroneous, Interpretation of the Printed Questions.

(g) The Appellee Had Placed At Its Disposal the "Exact Source" of Information From Which It Could Have Obtained Full and Complete Information on Everything It Now Claims Was Withheld From, and Misrepresented to, It.

(h) There Was No Fraud or Concealment.

### POINT III.

#### Insured in Possession of Requisite Good Health.

It is Appellant's position that there is no competent evidence with respect to the state of health of the "insured" when the application was approved, the policy was delivered, or when the first premium thereon was paid; and that the burden of proving that the "insured" was not in that state of health prerequisite to the validity of the insurance contract is upon the Appellee as the insurer. This is discussed under the following heading:

(i) Appellee Has Not Sustained the Burden of Proof, and There Is No Competent Evidence, With Respect to Any Unfavorable State of the Insured's Health When the Application Was Approved or When the First Premium Was Paid or When the Policy Was Delivered.

#### (a) The Parties to the Insurance Contract.

The insurance contract and policy in suit is not a contract with the "insured" therein named, as is usually and ordinarily the case. The policy was *about* the "insured," but not *with* him; it is a contract between Appellee, as the insurer, and Appellant as "applicant" [II, 405] for "beneficiary" [II, 405], and "the sole owner" [I, 39] of the policy the person to whom the policy was delivered [Finding VI] and by whom all (two annual) premiums were paid [Finding XXV].

Appellant's father, the now deceased "insured" merely *consented* that his life might be the subject matter of a

life insurance contract between Appellee, as the “insurer,” and Appellant. The “insured” did *not* sign the application as “the applicant” therefor; he signed “Part I” (the application) merely as the “proposed insured” [II, 405]. Appellant signed *only* “Part I” and as the “applicant for insurance” [II, 405].

The Appellant, and not the “insured,” is a party, other than appellee, to the insurance contract here involved. The policy on its face purports to be and is made with Appellant. It was procured and paid for by and delivered to Appellant as “the sole owner” [I, 39] thereof. The “insured” had no rights under the policy. Appellant was the *assured* and was the only party to the contract, other than Appellee, who had any rights therein or thereunder.

*Connecticut Mutual Life Ins. Co. v. Luchs* (1883),  
108 U. S. 498; 27 L. Ed. 800; 2 Sup. Ct. 949;

*Brockway v. Connecticut Mutual Life Ins. Co.*  
(1887), 29 Fed. 766;

*Worrell v. Life & Casualty Ins. Co.* (La. 1937),  
172 So. 788, reaffirmed in 175 So. 434;

*Millard v. Brayton* (Mass. 1901), 59 N. E. 436;  
*Cyrenius v. Mutual Life Ins. Co.* (N. Y. 1895),  
40 N. E. 225;

*Whitehead v. N. Y. Life Ins. Co.* (N. Y. 1886),  
6 N. E. 267;

44 C. J. S. 997, Sec. 238, Note 47.

In the *Whitehead* case, *supra*, where each of three policies on the life of the husband recited that the consideration was paid by the wife, and the money was to be paid to her, the court said:

“These contracts purport upon their face to be contracts with the wife as the party assured, and not

at all with the husband, who stands in the policy as simply the life insured; his conduct and death furnishing the contingencies upon which the liability of the insurer is made to depend. As was tersely expressed in the argument, the contract was about the husband, and not with him."

In the *Cyrenius* case, *supra*, the court said:

"The fact that the father signed the application with the son is not a circumstance of much significance as against the language of the policy itself. The defendant, before entering into the contract, needed to be informed in regard to the age, health and general history of the person whose life was the subject of the risk. No one could furnish that but himself. This was the main purpose of the father's signature to the application. \* \* \* The contract having been made with George in his own name for his own benefit, he alone \* \* \* is entitled to sue upon or enforce the defendant's promise."

The "insured" signed Part I (the application) as the "Proposed Insured," thereby *consenting* that his life might be the "subject of the risk" in a life insurance contract between Appellee and Appellant. The contract purports on its face to be and it is made with Appellant as the party assured, and not at all with the "insured" who stands in the policy as simply the life insured, the "insured's" death furnishing the contingency upon which the liability of the Appellee insurer is made to depend.

The Appellee was in the business and wanted to write and the Appellant wanted to buy the policy in suit, and it may be said that the insured's *consent* that his life be the subject of the risk, evidenced by his signing "Part I," was equally for the benefit of both of the contracting parties, *i. e.*, Appellant and Appellee. However, even if it be

arbitrarily assumed that the insured's signing of "Part I" were for the benefit of Appellant, the fact remains that there is no fraud, concealment or misrepresentation contained in "Part I."

Whether "Part I" was signed for the benefit of both of the contracting principals, Appellee and Appellant, or only for the benefit of Appellant, the fact remains that "Part II," the "insured's" medical history and authorization for full disclosure to Appellee of all information acquired by his attending physicians, including Dr. Rosenfeld, was, if not equally for the benefit of both, for the *sole* benefit of Appellee. It surely was *not* contemplated that the "insured's" medical history and waiver of privilege and express authorization for the revelation of privileged communications to Appellee by the "insured's" attending physician, Dr. Rosenfeld, was included in the *application*, as such, for Appellant's benefit.

Before Parts I and II became a part of the contract by the issuance of the policy, "Part I" thereof was an offer (in which the "insured's" prerequisite *consent* thereto was included) by Appellant to enter into a contract. Two days later, the "insured" *alone* submitted to a physical examination, gave his medical history and signed "Part II" including the waiver of privilege and express authorization for the revelation of privileged communications to Appellee .

The "Insured's" waiver of privilege was included in the application, *as such*, for a purpose in connection with the *application*, as such, and not solely that it might become a part of the contract when the policy, of which it was contemplated that it would become a part, was issued, to the end that it would be used only to defeat liability on the policy after the loss occurred.

(b) The Policy, Including "Part I" and "Part II" Does Not Provide, Either Expressly or by Implication, That Appellant's Rights Are Predicated Upon the Conduct of the "Insured."

Appellant's application for insurance on the life of his father, the now deceased "insured," is "Part I" [II, 405]. Appellant did not sign "Part II" [II, 406]. "Part II" bears the "signature of the person examined," *i. e.*, the "insured," who signed the same two days after he, as the "proposed insured," and Appellant, as the "applicant for insurance" signed "Part I."

While Appellant, as "applicant for insurance," in his application ("Part I"), agreed that it, "including Part II" should be attached to the policy when issued and become a part thereof, nevertheless, Appellant did not underwrite the accuracy of, or endorse or give any warranty as to the truthful character of, the representations contained in "Part II."

The contract in suit provides that it, the policy, "Part I" and "Part II" are merged and "constitute the entire contract between the parties." Thus, the application, as such, became *functus officio* when the policy was issued, and thereupon became a part of the contract.

While the policy provides (emphasis added) that "all statements made by the *Insured* or in his behalf, in the absence of fraud, shall be deemed representations and not warranties;"

and further provides that

"no such statement shall be used in defense to a claim unless contained in the application and unless a copy of such application is attached to" the policy when issued,

nevertheless, the converse of the latter provision is not stated and does not appear, viz.: the policy *does not provide* that such statements *may be used* in defense to a claim in such a case as this where the “insured” is not a principal contracting party and the contract is between the *insurer* and the *beneficiary*. The “insured” in the instant case *had no rights* under the policy and signed “Part II” only to waive rights and not to acquire any.

With respect to the provision

“\* \* \* All statements made by the insured or on his behalf, in the absence of fraud, shall be deemed representations and not warranties; \* \* \*” [Ex. 3].

it is pertinent to note that, inasmuch as the “insured” was not a principal contracting party, no statements were made, and nothing was said or done, “in his behalf”; and any fraudulent statement made by or attributed to him (which by reason of its fraudulent, actual or assigned, character would be declared a warranty rather than a representation under the above quoted provision of the policy), would merely constitute and be a warranty by one who, having no rights under the policy could forfeit no rights thereunder.

If the “insured” had been the “applicant” for the policy and thus one of the principal contracting parties, any fraudulent statement made by him in *his* application, “Part I” or in *his* medical history, “Part II,” would have vitiated the contract as a *matter of law* for a breach of warranty



as defined by the above quoted excerpt from the policy. The above quoted excerpt only defines the circumstance under which a statement or representation will become a warranty. The law, not the policy in suit, determines the legal consequences that flow from a breach of warranty made by one of the contracting parties. Fraud of the "insured" or a breach of warranty by him, *had he been one of the principal contracting parties*, would have vitiated the contract *as a matter of law* without any contract to that effect and there is no contract to that effect in the case at bar; that is *implied in law* in every contract as between the contracting parties.

In the instant case, as in all cases, if the fraud of, or a breach of warranty by, a third party (the "insured" in the case at bar), who is not one of the principal contracting parties, is to invalidate the contract, the policy by its own terms must expressly so provide inasmuch as such a provision is *not* implied in law and the contract of insurance is, under well recognized principles of law, to be liberally construed in favor of the *assured* and strictly construed against the insurer.

While the policy also provides that it is issued, among other things, "in consideration of the application" (even though the word "application" be erroneously construed to include "Part II" as well as "Part I"), nevertheless, it does not provide that the policy is issued in consideration of the "applicant's," *i. e.*, Appellant's statement or warranty that the statements or warranties of the "insured" in "Part II" are true or correct.

Appellant is not a third party beneficiary, and he relies on no contract made by the “insured.” Appellant relies on his own contract with Appellee under which the “insured” waived certain rights but acquired none.

The law provides that a breach of warranty by one of the contracting parties entitles the other to rescind. The law does not provide that a breach of warranty by a third person (the “insured”) will entitle either of the contracting principals to rescind in the absence of a contractual provision to that effect.

**(c) Neither Appellant Nor the Heirs or Personal Representatives of the Deceased “Insured” Could Waive the Latter’s Privilege With Respect to Confidential Communications to His Attending Physicians.**

Appellant did sign limited waivers after his father’s the “insured’s,” death, while Appellee was investigating the claim. These waivers, however, were limited and for the purpose of adjustment and settlement of the claim, and were legally insufficient under California law to overcome Appellant’s objection *upon the trial* to the admission of privileged communications between the deceased “insured” and his attending physicians.

*Aetna Life Ins. Co. v. McAdoo*, 106 Fed. (2d) 18.

Under the law in California, the heirs of the patient cannot waive the privilege.

*Estate of Flint* (1893), 100 Cal. 391.

Under the law in California, personal representatives of the patient cannot waive the privilege.

*Harrison v. Sutter Street Ry. Co.* (1897), 116 Cal. 156.

While the *Harrison* case, *supra*, was decided before California Code of Civil Procedure, Section 1881, was amended to provide that the institution of an action for wrongful death constitutes a waiver, nevertheless, the case is directly in point here and the amendment mentioned does not change the law in the situation here before the court inasmuch as the instant action is not one to recover for a wrongful death.

In the *Harrison* case, the personal representative of the decedent brought the action for the decedent's wrongful death. The trial court admitted, over defendant's objection, the testimony of a physician who treated the deceased during his lifetime, to prove that the injuries received while in a collision caused his death.

The Supreme Court held that that was error, saying:

"Under the principles announced in the *Estate of Flint*, 100 Cal. 391, 34 P. 863, the evidence should have been excluded. While the precise question here presented—whether, after the death of the patient, his legal representative may waive the objection which the statute gives, in terms, to the patient alone—was not there directly decided, it was, nevertheless, fully considered and discussed, and the meaning of the statute in that regard very clearly indicated in the following language: 'The question of waiver of the privilege by the personal representative or heir of

the deceased is a new one in this state, but the statute of New York bearing upon this matter is similar to the provision of our Code of Civil Procedure, and the decisions of the courts of that state furnish us ample light in the form of precedent. The Code of Civil Procedure of New York, section 836, provides that the privilege is present unless "expressly waived by the patient." The California provision contains the words "without the consent of his patient." It will thus be seen that the provisions are in effect the same.

The courts of New York, under this clause of the statute, have uniformly held that the patient alone can waive the privilege and when such patient is dead the matter is forever closed. *Westover v. Aetna Life Ins. Co.*, 99 N. Y. 56, 1 N. E. 104, 52 Am. Rep. 1; *Renihan v. Dennin*, 103 N. Y. 573, 9 N. E. 320, 57 Am. Rep. 770; *Loder v. Whelpley*, 111 N. Y. 239, 18 N. E. 874. \* \* \*

This construction is not unreasonable in view of the peculiar terms of our statute, and is undoubtedly fully supported by the New York authorities referred to in the case just cited; and, since our statute seems to be framed closely after that of New York, the construction given the latter by the courts of that state should have great weight with us in interpreting the meaning of our own."

Subdivision 4 of Section 1881 of the *California Code of Civil Procedure* announces the "policy of the law" and the rule with respect to privileged communications between a physician and his patient as follows:

"There are particular relations in which it is the *policy of the law* to encourage confidence and to preserve it inviolate; therefore, a person cannot be examined as a witness in the following cases:

“(1) \* \* \*

“(2) \* \* \*

“(3) \* \* \*

“(4) A licensed physician or surgeon cannot, without the consent of his patient, *be examined in a civil action*, as to any information acquired in attending the patient, which was necessary to enable him to prescribe or act for the patient; \* \* \*.” (Emphasis added.)

In the case of *In re Flint*, 100 Cal. 391, at page 396, the Supreme Court said:

“*This provision of law rests upon a sound public policy.* Its object and purpose is to enable the patient to make a full statement of his physical infirmities to his physician, with the knowledge that the law recognizes the communications as confidential, and guards against the possibility of his feelings being shocked or his reputation tarnished by their subsequent disclosure. To him, the considerations are even more weighty that the privilege remain inviolate after he has gone to his grave, for his good name is left behind deprived of his protecting care.” (Emphasis added.)

In the case of *Kramer v. The Policy Holders Life Insurance Ass'n.*, 5 Cal. App. (2d) 380, the court said in this connection that:

“Our state has proclaimed its attitude in favor of liberal construction. In the case of *McRae v. Erickson*, 1 Cal. App. 326, at pp. 331-332, the court says: ‘But to give to the statute this narrow construction would equally exclude from its application many if not most of the answers to questions usually put, and properly and necessarily put, by competent physicians

to patients in cases of this kind, in order to enable them to act for their patients. This, we think, would be to defeat the obvious purpose of the act, which, it is said, "*is to facilitate and make safe full and confidential disclosure by patient to physician of all facts, circumstances, and symptoms, untrammelled by apprehension of their subsequent and enforced disclosure and publication on the witness stand, to the end that the physician may form a correct opinion, and be enabled safely and efficaciously to treat his patient.*" (*Will of Bruendl*, 102 Wis. 47, 78 N. W. 169.) Hence, it is said in the case cited \* \* \*: "The seal placed on the lips of the physician only relates to 'information necessary to enable him to prescribe for such patient as a physician.' " *The tendency of all courts has been and should be toward liberal construction of these words to effectuate the purpose of the statute.*"

In the case of *Turner v. Redwood Mutual Life Ass'n.*, 13 Cal. App. (2d) 573, 576, the court in this connection, states that:

"In approaching the question we must bear in mind two well-settled rules of construction in California. (1) *That the provisions of subdivision four of section 1881 of the Code of Civil Procedure should be liberally construed in favor of the patient* (*Kramer v. Policy Holders etc. Assn.*, 5 Cal. App. (2d) 380 (42 Pac. (2d) 665); *McRae v. Erickson*, 1 Cal. App. 326 (82 Pac. 209)), and, (2) *that as the application and insurance policy were both prepared by the insurance carrier, and the provisions here in question are invoked to forfeit the policy, their terms should be strictly construed against it.* (*Witherow v. United American Ins. Co.*, 101 Cal. App. 334 (281 Pac. 668).)" (Emphasis added.)

- (d) After the Policy Was Issued, the "Insured's" Waiver of Privilege Was an Integral Part of, and Provision in, the Policy for the Appellee's Benefit; and Its Rights and Powers Thereunder May Not Be Exercised and Enjoyed by it Concurrently With Its Affirmative Repudiation and Prayer for Cancellation and Rescission Thereof.

The "Insured" in the instant case executed a waiver in "Part II," in words and figures as follows:

"\* \* \* I expressly waive to such extent as may be lawful, on behalf of myself and of any person who shall have or claim any interest in any policy issued hereunder, all provisions of law forbidding any physician or other person who has attended or examined me, or who may hereafter attend or examine me, from disclosing any knowledge or information which he thereby acquired, and I authorize any such disclosure." [II, 406.]

The policy in suit made the application a part of the contract, in words and figures as follows:

"This policy and the application, a copy of which is attached to and made a part of this policy constitute the entire contract between the parties. All statements made by the insured or in his behalf, in the absence of fraud, shall be deemed representations and not warranties; and no such statements shall be used in defense to a claim unless contained in the application and unless a copy of such application is attached to this policy when issued. \* \* \*" [I, 41.]

Appellant, in "Part I" (the application) the only document signed by him, agreed that:

"\* \* \* This application, including Part II, a copy of which shall be attached to the policy when issued, shall become a part of every policy issued hereon; \* \* \*" [I, 44.]

Accordingly, therefore, the only valid waiver of privileged communications entitling the Appellee to introduce testimony of the "insured's" attending physician with respect to the "insured's" medical history, health and physical condition, was a part of the policy itself, and an integral part thereof. After the waiver became merged into the contract, the insurer's subsequent exercise of its power to elicit information from the insured's attending physicians with respect to privileged matter was an exercise of a right accruing to Appellee under the contract. It is a well recognized rule that

"The insurer may not repudiate the policy, deny all liability, and at the same time be permitted to stand on a provision inserted in the policy for its benefit."

*Grant v. Sun Indemnity Co.* (1938), 11 Cal. (2d) 438, 440.

and cases there cited.

*Austin v. Hallmark Oil Co.* (1943), 21 Cal. (2d) 718, 727 (5);

10 Cal. Jur., Sec. 25, p. 645.



- (e) The Trial Court Erred in Admitting the Testimony of the Deceased Insured's Attending Physicians Over Appellant's Objections. In the Absence of Such Testimony, There Is No Evidence in Support of the Judgment.

The testimony of the insured's attending physicians, Dr. Rosenfeld and Dr. Seech, admitted over Appellant's objections, was also error because such evidence was hearsay insofar, at least, as the statements of the "insured" to the doctors were concerned.

*Yore v. Booth*, 110 Cal. 238.

The propriety of the application of the rule of law stated in *Yore v. Booth*, *supra*, is emphasized in the case at bar for the reason that in the *Booth* case, the *third party beneficiary* was the plaintiff suing, and she was merely the object of the insured's bounty under a contract of insurance which the insured made with the insurance company, while in the case at bar, the Appellant, in his own behalf and for his own benefit, rather than the insured, entered into the insurance contract with the Appellee insurer.

In the *Booth* case the court said, at pages 240, 241 :

"\* \* \* A person who procures a policy upon his own life, payable to a designated beneficiary, although he pays the premiums himself, and keeps the policy in his exclusive possession, has no power to change the beneficiary, unless the policy itself, or the charter of the insurance company, so provides. In other words, it is held that the beneficiary named in the policy, although he has parted with nothing, and is simply the object of another's bounty, has acquired a vested and irrevocable interest in the policy, which

he may keep alive for his own benefit by paying the premiums or assessments if the person who effected the insurance fails or refuses to do so.”

In the *Booth* case, the defendant, to avoid liability, urged that the insured falsely answered questions in the application with respect to his age, and offered evidence of the insured’s *prior* statements inconsistent with the answers in the insured’s application. This evidence was rejected on the ground that it was hearsay and the Supreme Court affirmed the judgment of the trial court on that ground, saying at pages 241, 242:

“\* \* \* Any declarations of the deceased, not made at the time of procuring the policy, or as part of the *res gestae*, were *hearsay* and incompetent. \* \* \*”  
(Emphasis added.)

- (f) **All Answers to the Printed Questions in Part II of the Application Are Written by and in the Longhand of the Medical Examiner and Represent His Interpretation of That Which He Considered the Material Portion of the Insured’s Answers to the Medical Examiner’s Interpretation, and in One Instance Admittedly Erroneous Interpretation, of the Printed Questions.**

The insured was Yiddish, was Jewish, read Hebrew but didn’t read English well. The evidence showed, the court said, that he didn’t read documents but he understood them when they were read to him, and he always had important documents read to him. Lawyers by whom he had been advised testified that, when they did anything for him, they read the documents to him or that someone came in and read them to him and then he exercised his judgment predicated upon what he heard [I, 359-360].

In propounding his interpretation of the printed questions in Part II to the "insured," the medical examiner sat across the desk from the "insured" facing him [I, 202]. All answers written in Part II were written in longhand by the medical examiner [I, 201]. The insured wrote nothing on Part II other than his own signature [I, 201]. After the medical examiner completed all the questions he turned the document around and asked the "insured" to sign it [I, 222].

The medical examiner did not record all of the insured's answers or such of the insured's answers as the medical examiner thought were "immaterial" [I. 215]. Some of insured's answers omitted in "Part II" were included in the medical examiner's confidential report [I, 214-15, 222]. The medical examiner did not ask all of the printed questions in "Part II" correctly, *e. g.*, subdivision "B" of question 35 indicates that the insured answered that he had *never* suffered from "insomnia." The question as printed is: "Have you ever suffered from: Insomnia?" The answer written by the medical examiner is: "No." *The "insured" made no such reply* to the question as printed. Actually, the "insured's" reply was: "yes" to the medical examiner's erroneous interpretation of the question, *viz.*: in interpreting that printed question and propounding it to the "insured," the medical examiner asked the "insured," and here we quote the record testimony of the medical examiner:

"I asked him (meaning the insured) if he slept well. He (meaning the insured) said 'yes.' That answer would be 'No' for insomnia" [I, 213].

The medical examiner's mistake in this respect is very natural and in no sense surprising in retrospect when consideration is given to the *form* of the printed question which appears as Number 35 in "Part II" to wit:

Have you ever suffered from:					
35 (Give details under 44)		A. Indigestion?	No.	B. Insomnia?	No.
C. Nervous strain or depression?	No.	D. Overwork?	No.	E. Dizziness or fainting spells?	No.
F. Palpitation of heart?	No.	G. Shortness of breath?	No.	H. Pain or pressure in the chest?	No.

It is obviously easy to *not read*: "Have you *ever* suffered from:" (emphasis added) before each of the eight (8) subdivisions of the above reproduction of number 35 of "Part II". However, that is precisely the admission of that which the medical examiner did with respect to subdivision "B" thereof [I, 213]. Perhaps the medical examiner's admission in this regard was an inadvertence while on the witness stand. If it was merely an inadvertence, it demonstrates how easily it can be and probably was slipped into with respect to the other seven subdivisions. If it can be so easily slipped into in open court when the witness's attention to the matter is concentrated and he is on the alert, it is obvious that the same inadvertence is more probable in the press of routine office procedure and expedition.

In further corroboration of the probability that the medical examiner failed to read "Have you ever suffered from:" before all of the 8 subdivisions of "35," is the striking coincidence that all the answers are "No," which is comprehensible if the medical examiner asked "*Do* you suffer from": or "*do* you *now* suffer from:" before each of the 8 subdivisions. On the other hand, it is *incredible*

that a man 64 years of age would say, or believe it credible to say, or that Appellee or its medical examiner or its medical director would believe that during all of his life of 64 years the insured had *never* suffered from “indigestion,” “insomnia,” “nervous strain or depression,” “overwork,” “dizziness or fainting spells,” “palpitation of heart,” “shortness of breath” or “pain or pressure in the chest.” It is preposterous that Appellee should have believed or relied upon a statement that any person 64 years old, who had a history of diabetes, sugar or albumen in his blood and previously rejected for insurance, *never* in 64 years had suffered from *any* of the maladies named.

Some parts of the answers in “Part II” are not even interpretations of answers of the “insured,” and on the contrary represent answers furnished by the medical examiner himself. This is demonstrated in several instances, *e. g.*, 36B of “Part II” requests the “insured” to “give reasons, name of practitioner and details under 44” if the “insured” had consulted or been examined by a physician or other practitioner within 5 years. Pursuant thereto, the medical examiner wrote under “Special Information” at 44 in his own longhand:

“Dr. Maurice H. Rosenfeld, 1908 August 1942 Physical examination and blood sugar determination report was normal.”

In explanation of the source of his information concerning and the meaning of “1908” in the last quotation above, the medical examiner explained as follows on his direct examination:

“Q. His (Dr. Maurice H. Rosenfeld) address, 1908 Wilshire Blvd? A. Yes.

Q. Did you just fail to put in ‘Wilshire Boulevard’? A. That’s right. [I, 216.]

Q. You did not make an error; you just failed to put in 'Wilshire Boulevard'? A. I omitted it, yes.

\* \* \* \* \*

Q. The court has suggested that the full address of the doctor was not listed on your item 44. Does that refresh your memory as to whether or not Mr. Lutz (the insured) said he had consulted Dr. Maurice H. Rosenfeld at 1908 Wilshire Boulevard? A. No, that's the office address of the doctor he consulted.

Q. From whom did you get the office address of Dr. Maurice H. Rosenfeld? A. I knew it. That's where his office was." [I, 217.]

**(g) The Appellee Had Placed at Its Disposal the "Exact Source" of Information From Which It Could Have Obtained Full and Complete Information on Everything It Now Claims Was Withheld From, and Misrepresented to, It.**

The "insured" gave Appellee the name of his attending physician, Dr. Maurice H. Rosenfeld, whose testimony, introduced over Appellant's objection in the trial of this case, demonstrated that he was thoroughly conversant with and readily disclosed every item of fact with respect to every item of alleged fraud, concealment and misrepresentation upon which Appellee relies and the judgment is premised.

The insured's concurrent waiver of privilege and express authorization for the revelation to Appellee of all privileged communications by "any physician or other person who has attended or examined me," obviously included Dr. Rosenfeld and placed at Appellee's disposal the "exact source" of information from which it could have obtained,

and after the “insured’s” death it did obtain, full and complete information on everything Appellee now claims was withheld from it.

The testimony, admitted over Appellant’s objection, of Dr. Maurice H. Rosenfeld, the “insured’s” attending physician, showed that *if Appellee had inquired of Dr. Rosenfeld, under the “insured’s” waiver of privilege in “Part II,” it would have received and elicited from him prior to the issuance of the policy in suit, the following information, to wit (in the order of the “insured’s” consultations with the doctor):*

1. First consulted by insured on January 16, 1937 [I, 101] who complained of dizziness, vertigo and inability to get out of bed [I, 102]. While the doctor diagnosed the condition as “probable slight” stroke which he “suspected as being very mild” and found some hardening of the arteries or arteriosclerosis and advised rest [I, 103], he did not tell the insured that he had suffered or sustained a stroke; the insured was told “that his general condition was satisfactory” but that the “question of a possible stroke had to be considered in view of the symptoms and the eye ground findings” [I, 134] made by an eye specialist, Dr. Stephen Seech, with whom Dr. Rosenfeld communicated directly [I, 124-125]. The insured had no pains [I, 142].

(Over Appellant’s objection [I, 156], Stephen G. Seech, M. D., specializing in ophthalmology [I, 155] with whom Dr. Rosenfeld communicated directly [I, 124-125], testified that he was consulted by the “insured”: on January 15, 1937 [I, 155], complaining that two days earlier he awakened with a dizzy head and was nauseated [I, 156].)

2. On January 19, 1937, Dr. Rosenfeld saw the "insured" again and the treatment was discussed. That was the last time Dr. Rosenfeld saw the insured for a number of years [I, 135].

3. On June 1, 1942, over 5 years after the last previous consultation, Dr. Rosenfeld next saw [I, 135] and examined [I, 105] the "insured" at which time he gave the "insured" a complete physical examination, made an electrocardiographic study and further study of the "insured's" blood, blood sugar, blood count and urinalysis. The doctor found the "insured" had an elevated abnormal blood sugar; blood pressure slightly elevated; a mild coronary ischemia [I, 105] which "is transitory" [I, 106] while the "probable" narrowing of the coronary arteries is chronic and "probably" progressive. The diagnosis was "probably" angina pectoris "probably" due to the coronary artery narrowing. The "insured" was advised to curtail activities, reduce weight by diet, "to improve this potential diabetic condition" and was given nitroglycerine, (sometimes prescribed for high blood pressure) [I, 135], for relief of pain [I, 106 & 137], which the "insured" for the first time complained of getting around his heart [I, 142] and which the "insured" thought were "gas" pains [I, 136]. The doctor's "suspicions" were that the "insured" had "mild" angina pectoris. The symptoms "were very mild" [I, 136]. The diagnosis of angina pectoris was "suspected" [I, 107], but it was Dr. Rosenfeld's policy, when he found a condition involving a suspicion of heart infirmity, not to make any statements which would make the patient unduly apprehensive [I, 119, 135]. The "insured" was also told about his "potential diabetic condition" [I, 107].

4. On June 3, 1942, Dr. Rosenfeld advised the "insured" that there was some abnormality in the cardio-



gram, not seen in the previous studies, which indicated that the pains of which the insured complained were due to his heart and "suggested" angina pectoris [I, 111]. In his testimony Dr. Rosenfeld said he found excessive sugar in the insured's blood on "one" occasion which he identified as this occasion, *i. e.*, June 3, 1942, [I, 145] although he previously testified he found on June 1, 1942, that the insured had an elevated abnormal blood sugar [I, 105].

5. On June 5, 1942, the "insured" had no complaints [I, 107]. The doctor made no examinations [I, 137].

6. On June 12, 1942, the "insured" said he had been feeling better than he had on the previous visits. He did not complain of pain, pressure in the chest or dizziness [I, 137].

7. On July 6, 1942, the "insured" stated he was feeling very much better; he said he was much improved [I, 138] and had no complaints [I, 115]. While the doctor "suspected the possibility of an acute coronary occlusion" and continued to believe that the "insured" had arteriosclerosis and angina pectoris [I, 116], nevertheless, he did not tell the "insured" what his diagnosis and conclusions were [I, 117]. The doctor testified that said diagnosis and conclusions were "just for my own information and a follow up for further diagnostic evidence" [I, 117]. The electrocardiograms taken on this date showed definite improvement and the doctor so advised the "insured" and recommended a "little vacation" [I, 139].

8. On August 7, 1942, the "insured" had no complaints and no pains [I, 140]. The doctor made a blood sugar test, found it to be normal, and so advised the "insured" [I, 140]. The examina-

tion and discussion that day “was primarily referable to the patient’s diabetic problem” and the doctor told the “insured” “that his blood sugar was essentially normal” [I, 118]. Having in mind the “insured’s” age, 64, it was the doctor’s opinion that the “insured” was in a good state of health “except for the pains and slight electrocardiograph changes” [I, 140].

9. On August 11, 1942, the last time the doctor saw the insured before November 16, 1942, when the latter signed the application [I, 144], the “insured” had no complaints; he was re-examined, and another electrocardiogram was taken. The doctor advised that although his suspicion was the same, nevertheless “there was no increase in impairment noticed” [I, 118]. The overall picture was that the “insured” was improving; he was better. From June 5, 1942, to August 11, 1942, he had improved [I, 141]. His blood pressure [I, 144] and blood sugar were normal [I, 145]. He was recovered from the pain [I, 150]. The appearance of the “insured” was that of a normal appearing man in every way [I, 144].

On April 7, 1944, or 19 months later, Dr. Rosenfeld in his office next [I, 143], and for the last time, saw the “insured” before his fatal illness [I, 144]. Dr. Rosenfeld did not see [I, 143] nor prescribe any medicine for [I, 144] the “insured” from August 11, 1942 to April 7, 1944 [I, 143-144].

Dr. Rosenfeld further testified that the insured died of “an accute attack of coronary thrombosis” [I, 119], which probably occurred several hours before his death [I, 143], but was sent to the hospital for an acute duodenal ulcer, *i. e.*, ulcer of the stomach [I, 120]. In all of the doctor’s examinations, there were no symptoms which could be as-

cribed to coronary thrombosis [I, 144]. Normal, healthy appearing people suffer from fatal attacks of coronary thrombosis without any previous symptoms and Dr. Rosenfeld could not determine in August, 1942, from any examination that he could or did make as a heart specialist, whether or not the insured had coronary thrombosis [I, 143].

It is possible for a person to have mild angina pectoris and thereafter effect a complete recovery. Many times a person will have all the symptoms of mild angina and, over a period of time and treatment, can completely recover [I, 149].

While, over Appellant's objection [I, 122-123], Dr. Rosenfeld stated that it was his "belief" that the "insured" had arteriosclerosis and angina pectoris during the 39 day period between Nov. 1, 1942 and Dec. 9, 1942 [I, 122-123], nevertheless, he did not see the "insured" or prescribe any medicine for him during the over 19-months period between August 11, 1942 to April 7, 1944 [I, 143-144] and this evidence of Dr. Rosenfeld with reference to said 39 day period should have been, and the trial court thought that it was, excluded as is demonstrated in the court's opinion where Judge Jenney, speaking of the evidence elicited from Dr. Rosenfeld, said:

"The testimony limits the information obtained by Dr. Rosenfeld from the deceased to that period of time prior to November 16, 1942" [I, 355].

Dr. Rosenfeld testified that during the months of November and December, 1942, and January, 1943, his office address was 1908 Wilshire Boulevard; telephone number was EXposition 1369; his bookkeeper's name was Miss Byington [I, 146] and that during that period he did not

[I, 148] receive any letters or communications from Appellee, New England Mutual Life Insurance Company of Boston, a corporation, with reference to the health, condition or treatment of the "insured" [I, 147-148] but that shortly after the "insured's" death, *i. e.*, subsequent to May 28, 1944, Dr. Rosenfeld received a form from Appellee to fill out [I, 148].

Dr. Rosenfeld thought he was in his own office [I, 151] when he filled out the certificate of death [Ex. C] which certified that the insured's cause of death was "acute coronary thrombosis" of only one day's duration; "angina pectoris" of a duration of "1 yr +" and duodenal ulcer of a duration of "2 Mo. +" [II, 420].

The "insured's" complaint of "gas" pains had nothing to do with "indigestion". There is no evidence in the record that the "insured" suffered from "indigestion". Dr. Rosenfeld explained (emphasis added) that when a "gas" pain "occurs on effort or on emotion, it becomes obvious that *the stomach is not the thing at fault*, but the heart. However, most patients who complain of pain or a peculiar sensation that is hard for them to describe, and they usually say it is gas pains primarily because of belching, and they say, 'I feel badly.' *This is a very common fallacy* and the differential point is that gas pains usually are associated in close relation to the intake of food, while the gas pain as caused by heart disease is related to emotion and strain" [I, 126].

While the "insured" complained of pain on June 1, 1942 [I, 142], which Dr. Rosenfeld said was due to the

heart [I, 107] and not the stomach [I, 126], which the "insured" considered a "gas" pain [I, 136], nevertheless the fact remains that the "insured" never had any condition which was diagnosed as "indigestion" or "palpitation of the heart." Unless pain in the "heart" is synonymous with pain in the "chest," the "insured" never had any pain in the chest and certainly he had no condition diagnosed as pain or pressure in the "chest."

*The appellee was in possession of facts which put it on notice and inquiry and which, if pursued, would have given it actual knowledge and full and complete information concerning everything it now claims was withheld from and misrepresented to it. Its failure to make such inquiry, when it could have conveniently done so, constitutes notice of that which the inquiry would have disclosed, and this constitutes a waiver of all right to complain that such information was withheld from or misrepresented to it.*

An insurance company may be charged with knowledge of facts which it ought to have known.

*Columbian Nat. Life Ins. Co. v. Rodgers*, 116 F. (2d) 705, citing

*Supreme Lodge K. P. v. Kalinski*, 163 U. S. 289, 41 L. Ed. 163.

In the *Columbian National Life Insurance Co.* case, *supra*, the beneficiary brought the action on a \$10,000 policy issued by the defendant insurance company on Feb. 5, 1935, where the insured died less than 6 months later, on August 4, 1935. The defendant insurer claimed that

the insured made false and fraudulent representations in his application in response to questions as to whether he had ever been declined insurance. The evidence showed:

1. The insured had previously applied to and was declined insurance by John Hancock Mutual Life Ins. Co.;
2. After the John Hancock Co. declined the issuance of a policy, information that it had the insured's application, and some other company has created a record against him, was given to members of the Medical Information Bureau ("MIB") without stating whether John Hancock Co. had issued or declined to issue a policy;
3. The above MIB information was in defendant's possession and before its proper agents when it issued the policy after previously having notified its agent that its delay on the application was because it was investigating Applicant's previous insurance record.
4. There was no evidence as to the investigation the defendant made but it was established that defendant made no investigation of John Hancock Co. which latter company imparted no information to the defendant prior to the latter's issuance of the policy in suit.

The court held that the defendant was put upon inquiry by information before it when it issued the policy and was estopped to assert that it was without knowledge concerning the facts involved in the previous unsuccessful application to obtain insurance.

Keeping in mind the fact that in the instant case the contract was between the Appellee insurer and the *assured* Appellant, and not with the latter's father, the so-

called "insured," the following sections of the Insurance Code demonstrate the impropriety of permitting the insurer to complain of the third party's (the "insured's") alleged concealment or misrepresentation:

PRESUMED KNOWLEDGE.

"Each party to a contract of insurance is bound to know:

- (a) All the general causes which are open to his inquiry equally with that of the other, and which may affect either the political or material perils contemplated.
- (b) All the general usages of trade."

335 *California Insurance Code*.

WAIVER OF RIGHT TO INFORMATION.

"The right to information of material facts may be waived \* \* \* by neglect to make inquiries as to such facts, where they are distinctly implied in other facts of which information is communicated."

336 *California Insurance Code*.

MATTERS NOT REQUIRED TO BE DISCLOSED EXCEPT  
UPON INQUIRY.

"Neither party to a contract of insurance is bound to communicate information of the matters following, except in answer to the inquiries of the other:

- 1. Those which the other knows.
- 2. Those which, in the exercise of ordinary care, the other ought to know, and of which the party has no reason to suppose him ignorant.
- 3. Those of which the other waives communication.
- 4. \* \* \*
- 5. \* \* \*

333 *California Insurance Code*.

Paraphrasing the above Insurance Code sections:

The Appellee insurer is bound *to know* the matters which “are open to” Appellee’s “inquiry equally with that of the” Appellant. (335 Insurance Code.)

Appellee’s right to information of material facts were waived by its neglect to make inquiries with respect thereto until after the loss occurred where such facts were distinctly implied in other facts communicated to Appellee with reference to diabetes, previous application for insurance rejected, consultation with heart specialist whose name was given together with express waiver of privilege and authorization for full disclosure (336 Insurance Code).

Appellant, *even if he were* conversant therewith, is under no duty to communicate information to Appellee with respect to matters which Appellee, in the exercise of ordinary care, ought to know, in the absence of Appellee’s direct inquiry *of Appellant* with respect thereto (333 Insurance Code).

#### REQUIRED DISCLOSURES.

“Each party to a contract of insurance shall communicate to the other, in good faith, all facts *within his knowledge* which are or which he believes to be material to the contract and as to which he makes no warranty, *and which the other has not the means of ascertaining.*” (Emphasis added.)

332 *California Insurance Code.*

Paraphrasing the above quoted Section 332, Appellant was under a duty to communicate to Appellee all facts *within Appellants knowledge* which Appellee did not have “the means of ascertaining.” Clearly, the Appellee had



“the means of ascertaining” from Dr. Rosenfeld all of the facts and information which it now claims was misrepresented to or withheld from it, and *there is no allegation or finding that such information was within Appellant’s knowledge.*

In the *Columbian National Life Insurance Co.* case, the beneficiary was suing on a contract between the insurer and the “insured” and as to which the plaintiff was only a third party beneficiary. In the case at bar, Appellant is suing on his own contract.

The case of *Turner v. Redwood Mutual Life Ass’n*, 13 Cal. App. (2d) 573 (hearing denied June 26, 1936), approved the doctrine of waiver and estoppel applicable in the case at bar. The insurance company in the *Turner* case, in the language of the decision (p. 575):

“\* \* \* sought to relieve defendant from liability under its policy because of *alleged fraud* on the part of the *insured* in making *untrue answers* in her *application* for the policy and in an application for its reinstatement made July 10, 1934. Defendant *asserts* that Mrs. Turner had suffered from *twenty-three ailments during the period between October 18, 1925, three years prior to the date of the application*, and the date of her death, and that these were *concealed* from defendant constituting *fraud* on her part voiding the insurance. It sought to support this defense by the *evidence* of the *physicians* who had *attended Mrs. Turner*. The trial court excluded the evidence of these witnesses under the provisions of subdivision four of Section 1881 of the Code of Civil Procedure. Defendant maintains that the provisions of this section were waived by Mrs. Turner by the quoted paragraph in her application

for insurance and that the testimony of the physicians who had treated her was therefore admissible.” (Emphasis added.)

On page 578 of the *Turner* case, the court said:

*“She gave the names of her attending physicians and defendant could have ascertained the exact nature of her illness and treatment had it sought that information before it issued its policy. There is nothing to show that the operation was not a complete success and that she had not ‘fully recovered’ from that illness as stated in the application.”* (Emphasis added.)

There, as here, the information which the insurance company claimed was withheld from it could have been obtained from the doctors whose names were listed on the application. In holding that the insurance company had waived any misstatement in the application and was estopped from asserting the purported fraud, the court said on page 578:

*“Defendant had placed at its disposal the exact source from which it could obtain the information which it now maintains was withheld from it. It did not choose to make any inquiry but issued its policy with extreme promptness, to say the least, and accepted deceased’s money for six years, during all of which time defendant led her to believe she had a valid and enforceable policy of insurance on her life. Under such circumstances defendant should not be permitted to come into court after death had sealed the insured’s lips and prevented her from explaining, if she could, why she did not mention an operation in 1926, when she did mention an illness and treatment by physicians which, we conclude from the evidence and proffer of proof occurred at the same time as the operation. The illness and some treatment, though*

not the correct organ involved, were disclosed, and only the fact of an operation to effect a cure was withheld. *As defendant made no investigation when it should and could have, and as it issued its policy of insurance, accepted Mrs. Turner's money for six years and lulled her into the secure belief that she had a valid policy of life insurance, it must be held that it waived the misstatement in the application and is now estopped from asserting the purported fraud.*" (Emphasis added.)

In *Columbian Nat'l Life Ins. Co. v. Rodgers*, 116 F. (2d) 705, 707, the court said in this connection:

"An insurance company may be charged with knowledge of facts which it ought to have known. See, *Supreme Lodge K. P. v. Kalinski*, 163 U. S. 289, 16 S. Ct. 1047, 41 L. Ed. 163. Knowledge which is sufficient to lead a prudent person to inquire about the matter, when it could have been ascertained conveniently, constitutes notice of whatever the inquiry would have disclosed."

**(h) There Was No Fraud or Concealment.**

Appellee claims, and the trial court, by finding XI, found [I, 52-53], that the insured concealed from it information to the effect that

Within 5 years the insured on numerous occasions other than in August, 1942, had consulted and been examined by physicians, had electrocardiograms taken, medicine prescribed to relieve heart pains, received treatment for and been told by his physician that he had angina pectoris and should curtail his activities,

by the insured's response, in the medical examiner's long-hand under item 44, to the direction in item 36 B to "give

reasons, name of practitioner and details under 44" if the "insured" had consulted or been examined by a physician or other practitioner *within 5 years* [I, 44], to wit:

"Dr. Maurice H. Rosenfeld 1908 August 1942 physical examination and blood sugar determination report was normal." [II, 406; I, 44.]

This criticism is wholly unwarranted, and there is no support in law or fact for such a finding for the reason that question 36A (answer in quotation), viz:

- 
- 36 A Have you consulted or been examined by, a physician or other practitioner within 5 years?  
"Yes"
- B If so, give reasons, name of practitioner and details under 44
- 

and particularly subdivision "B" thereof by a proper interpretation, and we don't know how the medical examiner read or interpreted it to the insured, does *not* request:

(1) That the insured state all reasons which may have prompted *all* consultations or examinations by *all* physicians or other practitioners over the whole 5 year period; or

(2) That the insured specify how many times in the then last 5 years he had consulted or been examined by a physician or other practitioner; or

(3) That the insured specify all or any diagnoses made and all or any treatments received over the whole 5 year period or any part thereof; or

(4) That the insured specify whether electrocardiograms were taken or how many were taken over the 5 year period; or

(5) That the insured name *all* physicians and other practitioners whom he consulted or by whom he was examined; or

(6) That the insured explain *all* or any prognoses made, recommendations offered, prescriptions written or medicines prescribed; or

(7) That the insured elaborate all or any symptoms, pains, or anxieties that had prompted each or every consultation with or examination by each or every physician or practitioner whom he had consulted or been examined by during the entire 5 year period.

It is Appellant's position that question 36, as properly interpreted, was correctly answered without concealment either in fact or legal contemplation when the medical examiner in his own longhand wrote:

(1) The word "yes" in response to subdivision question "A" thereof, to wit: "Have you consulted or been examined by a physician or other practitioner within 5 years?"; and

(2) In response to the subdivision "B" direction therein ("If so, give reasons, name of practitioner and details under 44"), the following:

---

44 Special Information:

"36. Dr. Maurice H. Rosenfeld—1908—August—1942—Physical Examination & blood sugar Determination—report was normal"

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The space provided in 44 for explanation or "Special Information" is so small [I. 44] as to indicate that no complete 5 year medical and diagnostic history is contemplated. Furthermore, the above quoted "Special Information" at 44, as written by the medical examiner, bears the interpre-

tation (by reason of the unintelligibility, uncertainty and ambiguity of the phrase "1908 August 1942"): that the "insured" had consulted and been examined by Dr. Rosenfeld over the period of from 1908 to August 1942, and not merely on one occasion in August, 1942, as it is construed in finding XI [I, 52-53].

The Appellee was well aware of the fact that its "Part II" and particularly question 36 "B" therein, did *not* request the "insured" to furnish, and that he had not furnished, as "Special Information" under 44, *all* "reasons" for, or *all* "details" of, the insured's consultation with or examination by Dr. Rosenfeld. This is demonstrated by Appellee's letter [II, 432] in explanation of telegram [II, 427] dated Dec. 1, 1942, advising that the issuance of the policy in suit was approved but that Appellee was unable to consider two additional policies requested aggregating an *additional* \$13,000 on the life of the "insured" "without a complete detailed statement from Dr. Rosenfeld *and* Dr. Lisner" (emphasis added), and that Appellee would like, to further quote Appellee's said letter, "*full* details" (emphasis added) as to:

- (a) "Why were the doctors consulted?"
- (b) "What were the symptoms?"
- (c) "What were the findings?"
- (d) "What treatment or advice was given?"
- (e) "What were the results?" [II, 432.]

Obviously Appellee was not only "on notice" but also "on inquiry". Nevertheless, Appellee claims that it was misled by, and there was fraud in, the "insured's" "No" answer to 4 interrogatories in 35, relative to:

- "A Indigestion?"
- "E Dizziness or fainting spells?"
- "F Palpitation of heart?"
- "H Pain or pressure in the chest?"

Appellee was not misled by any of the "No" answers to any of the above mentioned 4 interrogatories in 35. The only one of those "No" answers which could possibly be considered incorrect is the one in response to subdivision "E" with reference to

*"Dizziness or fainting spells?"*

This question in "Part II" appears immediately below the inquiry with reference to "Insomnia?" [II, 406] which the medical examiner clearly misinterpreted and erroneously propounded to the "insured" by *failing to ask* the "insured" if he had "ever" suffered from insomnia, as the printed question technically appears, and actually the medical examiner asked the "insured":

"Do you sleep well?" [I, 213].

The "insured" answered "yes" [I, 213] and the medical examiner, on the witness stand in open court still obtuse to the significance of the printed question, interpreted the answer of the "insured" as follows:

"That answer would be 'No' for insomnia" [I, 213].

While the medical examiner claims to have asked the "insured" whether he ever suffered from dizziness or fainting spells, it is obvious from the medical examiner's treatment of the inquiry with reference to insomnia (which in 35 of Part II appears immediately before and above), that the question probably and undoubtedly propounded to the "insured" in this connection was:

*"Do you suffer from dizziness or fainting spells?"*

meaning do you *now* or *currently* suffer from dizziness or fainting spells?

While it is true that on January 15, 1937 [I, 155], *over* 5 years prior to (November 16, 1942) the date on which

said "Part II" was signed by the "insured", he did complain of dizziness to the eye specialist, Dr. Seech [I, 156], and the next day with respect to the same complaint consulted Dr. Rosenfeld [I, 102], on May 21, 1938, the findings of Dr. Seech with respect to the same complaint were negative [I, 162]. That is all the evidence with respect to dizziness except that there is no evidence that the "insured" ever complained of dizziness again and there is substantial affirmative evidence that he *never again so complained* [I, 118, 137, 140].

*"A. Indigestion?"*

There is not any evidence in the record that the "insured" *ever* suffered from "indigestion". Dr. Rosenfeld explained [I, 126] that the so called "gas" pains with which the insured suffered were due to the heart; "the stomach is not the thing at fault".

*"F. Palpitation of the heart?"*

While the "insured" complained of heart pains, he *never* complained of "palpitation of the heart" and Dr. Rosenfeld's only diagnosis in this connection was "probably" angina pectoris "probably" due to the coronary artery narrowing [I, 106]. There is no evidence that the "insured" *ever* suffered from palpitation of the heart. Finding IX [I, 52] is ambiguous as to this.

*"H. Pain or pressure in the chest?"*

The "heart" is to be distinguished from the "chest". The "insured" did complain of pain in the region of his heart which on June 1, 1942, he thought were "gas" pains [I, 136] until Dr. Rosenfeld on that day explained that the pains were in, and due to, the heart itself rather than "gas" and that a diagnosis of angina pectoris was "sus-



pected" [I, 107]. Thereafter the pains disappeared [I, 107, 118, 137, 115, 140] which the doctor attributed to the "insured's" restriction of activity rather than to the nitroglycerine [I, 137] which is also prescribed for high blood pressure [I, 135].

Unless the terms "heart" and "chest" are synonymous and interchangeable, the "insured" *never* had any pain in the chest and certainly he had no condition diagnosed as "pressure" in the chest.

In *Lyon v. United Moderns*, 148 Cal. 470, the Supreme Court said in this connection:

"It must be recognized that the rule applicable in the construction of insurance contracts of construing the contract in favor of the assured and against the insurer, where it is reasonably susceptible of such construction, is applicable in such cases, '*where an insurance company or association seeks to avoid a policy or certificate of membership on the ground of falsity in an answer to a question which is by the terms of the contract made material, the court will construe the question and answer strictly as against the company, and liberally with reference to the insured,*' and, '*if any construction can reasonably be put on the question and the answer such as will avoid a forfeiture of the policy on the ground of falsity of the answer, that construction will be given, and the policy will be sustained.*' (Newton v. Southwestern Mut. Life Assn., 116 Iowa, 311, (90 N. W. 73)."  
(Italics supplied.)

Furthermore, if the medical examiner asked the "insured": "*Do you have*", rather than "Have you ever suffered from", pain or pressure in the chest, as the medical examiner undeniably and erroneously did with respect to the inquiry regarding "insomnia", it is obvious that the answer of the "insured" was correct. Cooley's Briefs on

the Law of Insurance (Vol. 3, p. 2594) is quoted with approval in *Lyon v. United Moderns*, *supra*, as follows:

“From an examination of the cases the following propositions may be regarded as established by the weight of authority: Where the insured, in good faith, makes truthful answers to the questions contained in the application, but his answers, owing to the fraud, mistake, or negligence of the agent filling out the application, are incorrectly transcribed, the company is estopped to assert their falsity as a defense to the policy. The acts of the agent, whether he is a general agent with power to issue policies, a soliciting agent, or *merely the medical examiner for the company*, are in this respect the acts of the company, and he cannot be regarded as the agent of the insured, though it is so stipulated in the application or policy.” (Emphasis added.)

While the pharmacist, H. C. Ludden, on March 23, 1945 [I, 79], testified, over Appellant's objection [I, 84], that the “insured” on June 1, 1942 [I, 84] “remarked that he did have a pain in his chest” [I, 88], nevertheless, the witness corroborated Dr. Rosenfeld's testimony that the pain was in the *heart*, rather than in the chest, of which fact the “insured” was again so advised and admonished by the directions which the witness Ludden said he placed on the bottle [I, 94, 95], to wit:

“Dissolve one tablet under tongue for *heart* pain.” (Emphasis added.)

As stated in the case of *Turner v. Redwood Mutual Life Ass'n*, 13 Cal. App. (2d) 575, at 578:

“\* \* \* *Under such circumstances defendant should not be permitted to come into court after death had sealed the insured's lips and prevented her from explaining, if she could, why she did not mention an*

*operation in 1926, when she did mention an illness and treatment by physicians which, we conclude from the evidence and proffer of proof, occurred at the same time as the operation. The illness and some treatment, though not the correct organ involved, were disclosed, and only the fact of an operation to effect a cure was withheld. As defendant made no investigation when it should and could have, and as it issued its policy of insurance, accepted Mrs. Turner's money for six years and lulled her into the secure belief that she had a valid policy of life insurance, it must be held that it waived the misstatement in the application and is now estopped from asserting the purported fraud."* (Emphasis added.)

- (i) **Appellee Has Not Sustained the Burden of Proof, and There Is No Competent Evidence, With Respect to Any Unfavorable State of the Insured's Health When the Application Was Approved or When the First Premium Was Paid or When the Policy Was Delivered.**

The application was approved November 27, 1942 [I, 255]. The policy was delivered and the first premium was paid on or about some date between December 7th and 9th, 1942 [I, 384].

Between August 11, 1942 and April 7, 1944, Dr. Rosenfeld did not see or prescribe any medicine for the insured [I, 143-144]. The trial court limited Dr. Rosenfeld's testimony to the information obtained by him *prior* to November 16, 1942 [I, 355].

The Appellee's medical examiner has been a practicing physician since 1910 [I, 199], has practiced or been admitted to practice in California since 1917 [I, 199] and has specialized in physical examinations of persons who apply for insurance since 1927 [I, 199].

On November 16, 1942 [I, 201], after giving the "insured" a physical examination [I, 207, 221] and having in mind the fact that the insured was 64 years of age [I, 212], it was the opinion of the medical examiner that the insured was in *good health* [I, 212], a *normal state of health* [I, 211], and an *insurable risk* [I, 219].

The insured died of an acute attack of coronary thrombosis [I, 119]. He was sent to the hospital for an acute ulcer of the stomach [I, 120]. It is possible for a person to have mild angina pectoris and thereafter effect a complete recovery and many times a person will have all the symptoms of mild angina and over a period of time and treatment can completely recover [I, 149]. Normal healthy appearing people suffer from fatal attacks of coronary thrombosis without any previous symptoms [I, 143]. On August 11, 1942 [I, 144], when Dr. Rosenfeld last saw the insured before the latter signed "Part II" on November 16, 1942 [II, 406], the insured had no complaints [I, 118] and although the doctor testified his "suspicion" was the same [I, 118], nevertheless, the insured was improving and was better [I, 141]. His blood pressure [I, 144] and blood sugar were normal [I, 145]. He was recovered from the pain [I, 150]. The appearance of the insured was that of a normal appearing man in every way [I, 144].

There is no competent evidence that the insured was not in good health at all times between November 16, 1942 when "Part II" was signed to and including December 9, 1942, when the policy was delivered and the premium was paid [II, 384].

### Summary.

The Appellant was guilty of no fraud, misrepresentation or concealment, and the "insured" was innocent thereof. Question 36 A in "Part II" asked whether the "insured" had consulted or been examined by "a physician" within 5 years; not how many, as Appellee claims and is implied in the trial court's Finding XI.

Appellee's medical director [I, 247], Harold M. Frost, M. D. [I, 246], who approved [I, 255] the application, testified that he knew that the insured had consulted a doctor other than the one mentioned by the "insured" in "Part II" [I, 295]. This knowledge, and information that the "insured" had been previously rejected for insurance on account of sugar in his urine [I, 216], had a history of diabetes [I, 216], had recently lost weight [II, 406] and had consulted Dr. Maurice H. Rosenfeld [II, 406], who gave the "insured" a general physical examination, checked his heart and listened to his chest [I, 218], put Appellee on notice and it was on inquiry [II, 432] of its general agents [I, 271] in Los Angeles to secure the information from Dr. Rosenfeld which it now claims was withheld from, and misrepresented to, it.

Simultaneously with its inquiry [II, 432] of its general agents to get in touch with Dr. Rosenfeld and without waiting for any reply thereto, Appellee consciously took a chance, because the risk was with reference to an amount less than \$15,000.00, and issued the policy in suit knowing the insured had not mentioned Dr. Lisner or furnished Appellee with "full details" as to "why" he consulted the

doctors, "what" the symptoms, findings or results were, or what treatment or advice was given [II, 432].

By furnishing Appellee with Dr. Rosenfeld's name and address and executing the waiver of privilege and authorization for full disclosure, the insured placed at Appellee's disposal the "exact source" of information from which Appellee could have obtained full and complete information on everything it now claims was withheld from, and misrepresented to, it.

It is with poor grace that Appellee, after the death of the insured and the loss has occurred, inequitably, illogically and illegally, in its effort to avoid liability, urges, *in its own complaint*, that the insurance contract is void, and at the same time seeks, and is allowed, to stand on the insured's waiver of privilege and express authorization for full disclosure, a provision expressly made a part of the contract, then being repudiated as void, by Appellee. Cases cited show the law does not sanction or permit such inconsistency. "The insurer may not repudiate the policy, deny all liability, and at the same time be permitted to stand on a provision inserted in the policy for its benefit."

Even if Appellee's position with respect to the insured's waiver of privilege and express authorization for full disclosure were tenable, and under the law it is not, nevertheless, statements and complaints of the *deceased* made *prior* to the date of the application, to his attending physician or anybody else were hearsay as to Appellant. This would apply to all subjective symptoms on which diagnoses were based. Such evidence was clearly hearsay and erroneously admitted over Appellant's timely objections.

There is no evidence in the record with respect to any unfavorable state of the insured's health when the application was approved, the policy was delivered and the first

premium thereon was paid. Appellee's own medical examiner gave the insured a complete physical examination on November 16, 1942, in connection with the insured's execution of "Part II" and, having in mind the fact that the insured was 64 years of age, it was the opinion of said medical examiner that the insured was then in a normal state of good health and an insurable risk.

### Conclusion.

It is respectfully submitted, therefore, that the trial court committed errors of law in

1. Denying Appellant's motion to dismiss;
2. Admitting, over Appellant's objection, testimony of insured's attending physicians with respect to the health and physical condition of the insured;
3. Admitting, over Appellant's objection, testimony of witnesses with respect to statements made by the "insured" prior to the date of the application for the policy in suit, which said statements were not part of the *res gestae*;
4. Failing to find that Appellee had waived its right to complain of concealment or fraud alleged or to claim that the insured was not in good health when the application was approved, the policy was delivered and the first premium thereon was paid;
5. Failing to find that Appellee was estopped to deny liability on the ground of fraud or concealment alleged, or to claim the insured was not in good health when the application was approved, the policy was delivered and the first premium thereon was paid;
6. Decreeing rescission and cancellation of the policy for alleged misrepresentation and concealment attributed to the then deceased insured with respect to his health and medical history.

It is respectfully further submitted that there is no competent evidence to sustain the trial court's findings of fact and conclusions of law, to which exception is taken in the specification of errors numbers (5) and (6) respectively, *supra*;

There was no fraud, misrepresentation or concealment. Even if there were, and Appellant makes no such concession, Appellee waived its right to complain, and is estopped to deny liability by reason, thereof inasmuch as it was on notice and inquiry but elected to make and made no investigation, and consciously took a chance because the risk was small in its opinion although the exact source of the information, which it claims was withheld from and misrepresented to it, was made available to Appellee at the time "Part II" was signed by the insured.

The insured's statements to his physicians made prior to his execution of "Part II" were privileged and inadmissible in evidence under the insured's waiver of privilege in the policy, which made the waiver a part of the insurance contract if the contract was void as Appellee claimed and in its complaint alleged. Such statements were also hearsay as to Appellant.

Respectfully submitted,

McLAUGHLIN, MCGINLEY & HANSON,  
*Attorneys for Appellant.*

WILLIAM L. BAUGH,  
*Of Counsel.*







## APPENDIX.

[Title of District Court and Cause.]

### CONCISE STATEMENT OF POINTS ON APPEAL UNDER RULE 19(6).

Notice Is Hereby Given that at the hearing of this appeal, appellants will rely upon the following points:

#### Point I.

The trial court erred in denying defendants' motion for dismissal at close of plaintiff's case. This error resulted primarily from (a) failure properly to apply the law of contracts which prevents a party from claiming and enjoying the benefits of a contract at the same time while urging the contract to have been void from its inception. The plaintiff had denied liability under the policy of insurance in suit, yet was permitted to claim the benefits of a waiver of confidential communications signed by insured on the application which was made a part of the policy by incorporation; and (b) failure to decree that plaintiff had [74] waived and was estopped to claim that material information had been withheld from it relative to insured's physical condition and medical history.

#### Point II.

The trial court erred in admitting, over objection of the defendants, testimony of insured's attending physician disclosing information relating to the health and physical condition of the insured during his lifetime. Such information was acquired from insured to enable said attending physician to prescribe treatment. This error was contributed to by the court's failure to rule that (a) a phy-

sician may not, without the consent of his patient, be examined in a civil action as to any information acquired in attending the patient which was necessary to enable him to prescribe or act for the patient; (b) plaintiff insurance company was prohibited and estopped from claiming and enjoying the benefits of the waiver which, by the terms of the policy, was expressly made a part of the contract, when it affirmatively appeared by the pleadings and proof that plaintiff insurance company denied all liability under said policy and claimed that said contract was void from its inception; and (c) certain limited and special waivers signed by the beneficiary under the policy, after the insured's death, did not constitute general waivers of privileged communications relating to the insured's health and medical history.

### Point III.

The trial court erred in decreeing rescission and cancellation of the policy in suit for fraud of insured in allegedly concealing and misrepresenting material facts relative to the insured's health and medical history. This error resulted from a failure properly to apply the law of waiver and estoppel against plaintiff insurance company under the special facts shown by the evidence.

### Point IV.

The trial court erred in failing to decree that plaintiff [75] had waived the alleged fraud complained of. This error resulted from an improper interpretation and application of the law relating to the defense of waiver in view of the evidence showing that (a) plaintiff insurance com-

pany had placed at its disposal, prior to the issuance of the policy in suit, the exact source from which it could have obtained the information upon which the court decreed rescission and cancellation; (b) plaintiff insurance company was furnished with a waiver of confidential communications, the name of insured's attending physician, the fact of a physical examination shortly prior to the date of the application, yet made no investigation or an incomplete investigation, promptly issued its policy and accepted without protest two annual premiums; and (c) plaintiff insurance company remained silent during the lifetime of insured, and following the death of insured and filing of notice of claim and proof of death, for the first time, by investigation disclosed facts concerning insured's health and medical history, which could have been ascertained by it prior to the issuance of the policy, or, in any event, during the lifetime of insured, by contacting insured's attending physician.

#### Point V.

The trial court erred in failing to find that plaintiff was estopped from asserting the alleged fraud complained of. The error resulted from an improper interpretation and application of the law relating to the defense of estoppel under the circumstances set forth under Point IV. Additionally, (a) the defendant Harry Lutz had caused to be cancelled, to his prejudice, other insurance policies on the life of the insured, in the belief that the policy in suit was valid; and (b) no attempt was made by plaintiff insurance company to cancel or rescind the policy in suit until after the death of the insured and subsequent to the

time defendant Harry Lutz had materially changed his position [76] by accepting lesser benefits from paid-up policies on the life of insured.

Dated: September 7, 1945.

McLAUGHLIN & McGINLEY,

JOHN P. McGINLEY

W. L. BAUGH

Attorneys for Appellants Harry Lutz and  
Harry Lutz and Rose Lutz as Executor  
and Executrix of the Last Will and  
Testament of Abe Lutz, Deceased.

Address: 1224 Bank of America Building  
650 South Spring Street  
Los Angeles 14, California

Received copy of the within document this 7th day of Sept. 1945. Meserve, Mumper & Hughes, by Berta Dietrich, Attorneys.

[Endorsed]: Filed Sep. 7, 1945. [77]

No. 11180

IN THE

# United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

---

HARRY LUTZ and HARRY LUTZ and ROSE LUTZ, as  
executor and executrix of the last will and testament  
of Abe Lutz, deceased,

*Appellants,*

*vs.*

NEW ENGLAND MUTUAL LIFE INSURANCE COMPANY OF  
BOSTON, a corporation,

*Appellee.*

---

Upon Appeal from the District Court of the United States for the  
Southern District of California, Central Division.

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## APPELLEE'S BRIEF.

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MESERVE, MUMPER & HUGHES,  
ROY L. HERNDON,

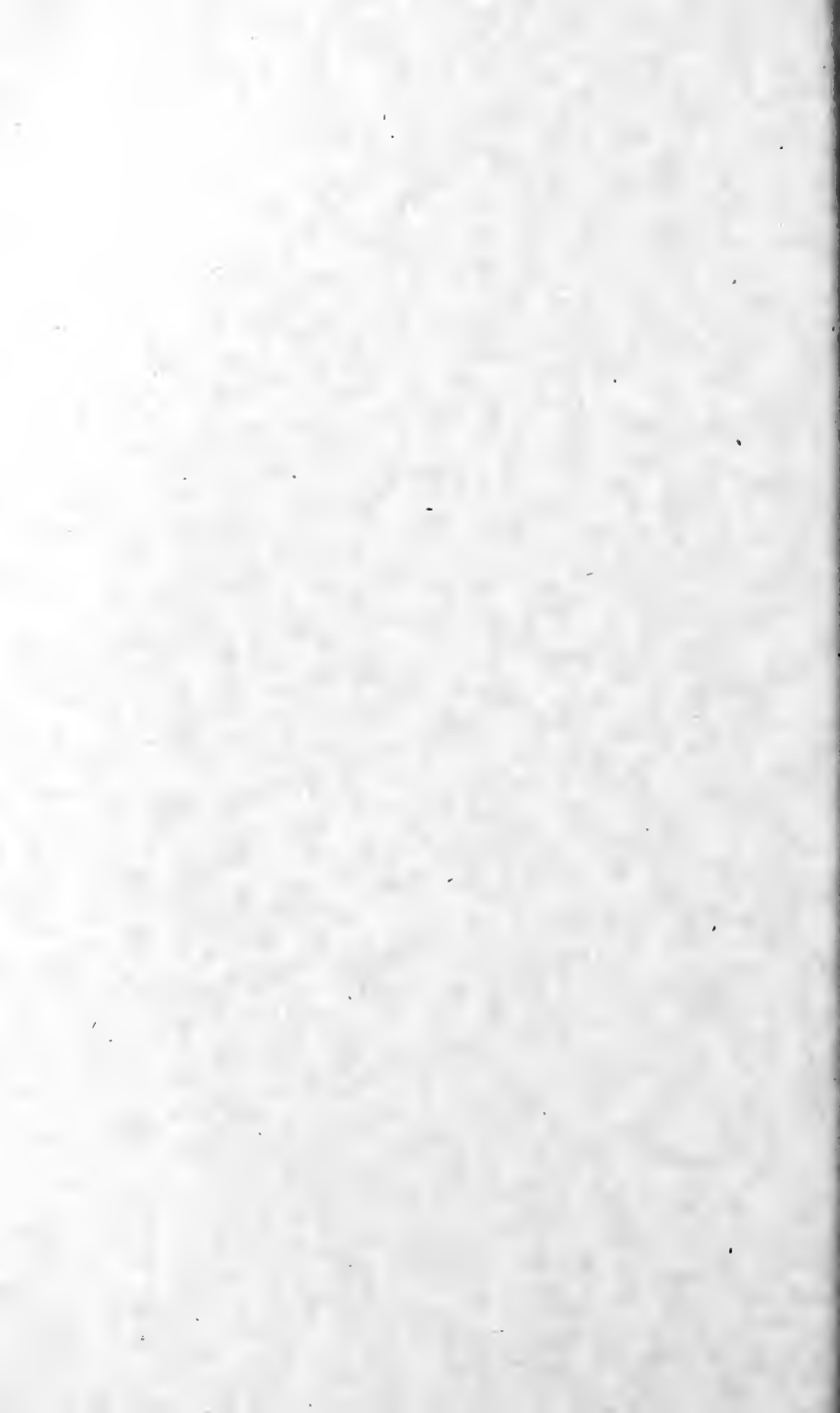
615 Richfield Building, Los Angeles 13,

*Attorneys for Appellee.*

FILED

MAR 28 1946

W. P. O'BRIEN.





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No. 11180

IN THE

# United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

---

HARRY LUTZ and HARRY LUTZ and ROSE LUTZ, as  
executor and executrix of the last will and testament  
of Abe Lutz, deceased,

*Appellants,*

*vs.*

NEW ENGLAND MUTUAL LIFE INSURANCE COMPANY OF  
BOSTON, a corporation,

*Appellee.*

---

## APPELLEE'S BRIEF.

---

### Statement of the Case.

This action was brought by appellee, a life insurance company, to rescind and cancel a certain policy of life insurance insuring the life of one Abe Lutz, hereinafter referred to as the "insured" [R. 2 to 21]. Appellee's amended complaint alleged in substance that matters of fact relating to the health and medical history of the insured, and material to the risk insured against, were misrepresented and concealed in the application for said policy [R. 6 *et seq.*]. It was further alleged in the amended complaint that the insured was not in good

health, either at the time said application was approved by appellee or at the time the first premium was paid by appellant, and that, by reason of said fact, the policy, according to its terms, never became effective [R. 14, 15].

After a trial on the merits, the court below made findings of fact sustaining all the material allegations of appellee's amended complaint [R. 49 to 61]. The court further found, contrary to the contentions of appellant, that appellee had not waived, and was not estopped to assert, its right to rescind and cancel the policy [R. 56 to 59].

Upon these findings, the trial court concluded that appellee was justified in rescinding and cancelling the policy and, further, that, by reason of the fact that the insured was not in good health when the application for the policy was approved and when the first premium thereon was paid, the policy, by its terms, failed to become effective [R. 60, 61]. Judgment was accordingly rendered, declaring the rescission and cancellation of the policy and denying appellant any recovery thereon [R. 62, 63]. Reference to the record discloses the abundant sufficiency of the evidence to sustain the findings of the District Court.

On November 14, 1942, Abe Lutz, as "Proposed Insured," and appellant Harry Lutz, as "Applicant for Insurance," signed Part I of an application to appellee for the issuance of a policy of ordinary life insurance in the amount of \$13,000.00 upon the life of said Abe Lutz, said insurance to be payable to appellant, whose relationship to the insured was stated to be that of a son. Part I of the application is designed to elicit information as to the place of residence, age and occupation of the proposed insured, the amount and form of insurance applied for,

the name of the proposed beneficiary, etc. Part I of the application contains the following provision:

“It is Hereby Agreed that this Application, including Part II, a copy of which shall be attached to the Policy when Issued, shall become a part of every Policy issued hereon; that acceptance of a Policy shall constitute ratification of any and all changes noted by the Company under ‘Additions and Amendments,’ and that the insurance applied for shall not take effect unless and until this Application is approved by the Company at its Home Office and the first premium is paid while the Proposed Insured is in good health; provided that subsequent premiums shall be due and subsequent policy years begin as shown on the first page of the Policy. If, however, the first premium is paid with this Application, and it is so stated in answer to Question 24, the insurance shall take effect as stipulated in the Conditional Receipt.” [R. 392.]

On November 16, 1942, the insured submitted to a physical examination by appellee’s medical examiner, and then and there signed Part II of the application for said policy, which sets forth the questions propounded by the medical examiner concerning the health and medical history of the proposed insured and the answers of the latter in response to said questions [R. 393]. The following questions and answers, among others, appear:

“29. What illnesses, diseases or injuries have you had since childhood? Describe fully.

<i>Name of disease</i>	<i>Date of attack</i>	<i>Duration</i>	<i>Severity</i>	<i>Results</i>
<i>Influenza</i>	<i>1918</i>	<i>2 weeks</i>	<i>Mild</i>	<i>Good</i>
<i>Slight colds</i>				
<i>occasionally</i>	<i>None for 1 year</i>		<i>Mild</i>	<i>Good</i>
*	*	*	*	*

35. Have you ever suffered from: (Give details under 44)
- A. Indigestion? *No.*
  - B. Insomnia? *No.*
  - C. Nervous strain or depression? *No.*
  - D. Overwork? *No.*
  - E. Dizziness or fainting spells? *No.*
  - F. Palpitation of heart? *No.*
  - G. Shortness of breath? *No.*
  - H. Pain or pressure in the chest? *No.*
36. A. Have you consulted, or been examined by, a physician or other practitioner within five years? *Yes.*
- B. If so, give reasons, name of practitioner and details under 44.

\* \* \* \* \*

44. SPECIAL INFORMATION:

36. *Dr. Maurice H. Rosenfeld, 1908, August 1942, Physical examination and blood sugar determination—report was normal.*
30. *Tonsils were slightly enlarged previous to tonsilectomy—1930—good results."*

It will be observed that the insured, by his answers to the questions contained in the application, specifically denied that he had ever suffered from indigestion, nervous strain or depression, dizziness or fainting spells, palpitation of the heart, shortness of breath or pain or pressure in the chest. Question number 36 inquired whether insured had consulted, or been examined by, a physician within five years, and, if so, required the giving of reasons, name of practitioner and details. In response to this question, the insured disclosed that he had consulted



Dr. Maurice H. Rosenfeld in August, 1942, for physical examination and blood sugar determination, stating that "report was normal."

Below the above stated questions and answers, and immediately above the signature of the proposed insured, the following statement appears:

"I certify that I have read my answers to the foregoing questions, that they are true and complete, and that they are correctly recorded. I expressly waive to such extent as may be lawful, on behalf of myself and of any other person who shall have or claim any interest in any policy issued hereunder, all provisions of law forbidding any physician or other person who has attended or examined me, or who may hereafter attend or examine me, from disclosing any knowledge or information which he thereby acquired, and I authorize any such disclosure." [R. 393.]

On December 1, 1942, appellee issued the policy in suit in the amount of \$13,000.00 [R. 39 to 46]. Said policy recites on its face that it is issued "in consideration of the application" and of the annual premium therein provided to be paid. The policy contains, among others, the following provision under the sub-title "CONTRACT":

"This Policy and the application, a copy of which is attached to and made a part of this policy, constitute the entire contract between the parties. All statements made by the Insured or in his behalf, in the absence of fraud, shall be deemed representations and not warranties; and no such statement shall be used in defense to a claim unless contained in the application and unless a copy of such application is attached to this Policy when issued. No endorsement or alteration of this Policy and no waiver of

any of its provisions shall be valid unless made in writing by the Company and signed by its President, Vice-President, Secretary, Assistant Secretary or Registrar; and no other person shall have authority to bind the Company in any manner.” [R. 41.]

A photostatic copy of the application was attached to the original of the policy [R. 44]. The policy was delivered to appellant Harry Lutz at Los Angeles, California, on or about December 9, 1942, at which time the first annual premium was paid [R. 384].

The insured died on May 28, 1944, that is, approximately seventeen months after the date of the issuance of the policy. In the death certificate filed with the Bureau of Vital Statistics, the causes of death were stated to be acute coronary thrombosis, angina pectoris and duodenal ulcer [R. 420].

Subsequent to receipt of the proofs of death, appellee instituted an investigation which lead to the discovery that material facts concerning the medical history and state of health of the insured had been concealed and misrepresented in the application [R. 297].

One of the witnesses called by appellee at the trial was Stephen G. Seech, a physician and surgeon specializing in ophthalmology. This physician testified that he was consulted by the insured on January 15, 1937 [R. 155], at which time the insured informed the doctor that he had been suffering from dizziness and nausea [R. 156]. The doctor testified that he examined the insured's eyes with an ophthalmoscope and found “several very tortuous vessels \* \* \* and a few punctuate hemorrhages” [R. 156]. The doctor testified that the hemorrhages could indicate several conditions, including diabetes, per-

nicious anemia and arteriosclerosis [R. 160]. At the time of the first consultation, Dr. Seech gave the insured a prescription for phenobarbital tablets, the purpose of which was "to quiet the apprehension of the patient" [R. 162].

At the time of a second consultation in October, 1937, Dr. Seech gave the insured a prescription for saturate solution of potassium iodine, the purpose of which was "to hasten the absorption of blood" [R. 163]. On the occasion of a third consultation with Dr. Seech on May 21, 1938, the insured again complained of dizziness [R. 161].

Appellee also called as a witness Dr. Maurice H. Rosenfeld, a physician specializing in diseases of the heart [R. 98]. Dr. Rosenfeld testified that he was first consulted by the insured on January 16, 1937, the patient having been referred to him by a Dr. Polesky [R. 101].

On the occasion of the first consultation, the insured complained to Dr. Rosenfeld "of dizziness and inability to arise the week before the examination of January 16, 1937" [R. 102]. The doctor made a complete physical examination and laboratory study, and took an electrocardiograph. Dr. Rosenfeld testified that he thereupon made a diagnosis of "probable slight stroke," and that he found evidence of arteriosclerosis, or hardening of the arteries, a disease which he stated was "progressive and chronic" [R. 103]. Dr. Rosenfeld further testified:

"I advised the patient that he had a mild stroke, in that he had symptoms which were suggestive and that, together with the report by an eye specialist who I had seen, suggested this condition, and for that reason I advised him of this possible diagnosis." [R. 104.]

The insured again consulted Dr. Rosenfeld on June 1, 1942, complaining that on excitement, strain or effort, he was subject to pain in the heart region [R. 104]. After the consultation of June 1, 1942, and after studying the electrocardiograph taken on that date, Dr. Rosenfeld made a diagnosis of probable angina pectoris, due to narrowing of the coronary artery. Dr. Rosenfeld advised the insured to curtail his activities, and gave him a prescription of nitroglycerine tablets for relief of the pain of angina pectoris, which the doctor described as an acute pain referable to the heart region [R. 106].

The insured went to the office of Dr. Rosenfeld for further examinations and for the taking of electrocardiographs on June 3, June 5, June 12, July 6, August 7 and August 11 of 1942. On each of these several occasions, the doctor told the insured "that in view of the fact that he was subject to pain around his heart that occurs after exercise or effort or after emotion, together with the minor changes noted in the electrocardiogram, that it was my opinion that these were due to a condition known as angina pectoris" [R. 117].

Dr. Rosenfeld testified that angina pectoris, caused by the narrowing of the coronary artery, was "a chronic disease manifested by an acute exacerbation of pain" [R. 119]; that "the condition that was the actual cause of death was just a continuation of the process of angina pectoris" [R. 121]; and that the insured was suffering from arteriosclerosis and angina pectoris during the period from June 1, 1942, to December 9, 1942 [R. 120 to 123].

Appellee called as a witness one H. C. Ludden, a pharmacist, who testified that he had known Mr. Lutz, the insured, for some twenty years [R. 81]; and that on

June 1, 1942, the witness, at the request of the insured, filled a certain prescription for nitroglycerine tablets [R. 83]. This prescription, which had been given the insured by Dr. Rosenfeld, is in evidence as Plaintiff's Exhibit No. 7 [R. 401]. The direction written on the prescription is as follows: "Sig.—Dissolve one tablet under tongue for heart pain." With reference to his discussion with the insured on June 1, 1942, Mr. Ludden testified further as follows:

"Q. On that occasion, Mr. Ludden, did Mr. Lutz express to you anything to the effect that he was suffering from any pain or illness? A. Mr. Lutz came in and simply handed me the prescription, and made the remark that he did have a pain in his chest, and would like to have the prescription as soon as possible.

Q. Did you have occasion to refill the prescription for nitroglycerine, which has been identified as Plaintiff's Exhibit No. 7 for identification? A. Many times.

Q. How many times would you estimate, Mr. Ludden, did you refill the prescription which is Plaintiff's Exhibit No. 7 for identification, between June 1, 1942, and October 31, 1942, if you can estimate it? A. That would be pretty hard to state.

Q. Would you say as much as twice? A. I would say about four times." [R. 88.]

\* \* \* \* \*

"Q. Please read to us the part or parts, if any, on that exhibit, which is Plaintiff's Exhibit No. 7, which you placed on the bottle. A. The words: Prescription No. 89543. Dr. M. H. Rosenfeld. Dissolve one tablet under tongue for heart pain. Mr. Lutz. 6-1-42.

Q. Do I understand that that portion of the exhibit which you have just read was placed by you on the label of the bottle? A. Yes, sir." [R. 94.]

The foregoing summary of the evidence suffices to demonstrate the substantial foundation upon which the findings of the District Court are based. These findings include the following:

"That in and by said application for said policy of insurance, said Abe Lutz, insured, represented to plaintiff company that said Abe Lutz had never suffered from indigestion, dizziness or fainting spells, palpitation of the heart or pain or pressure in the chest. That said representations were false and were known by said insured to be false at the time said application was made and signed; that prior to the time that said application for insurance was made and signed, said insured had suffered from indigestion, dizziness and fainting spells and from pain in the chest." [Finding No. IX, R. 52.]

"That in and by said application for insurance, the insured was asked whether he had consulted or been examined by a physician or other practitioner within five years prior to the date thereof, and, if so, to give reasons, name of practitioner and details with reference thereto. That in response to said questions, the insured disclosed no information except that he had consulted Dr. Maurice H. Rosenfeld in August, 1942, and was given at that time a physical examination and blood sugar determination; and insured represented that the report of said examination was normal." [Finding No. X, R. 52.]

"That, within five years prior to the date of said application, said insured had consulted, and had been examined by, physicians at times other than in

August, 1942; that within five years prior to the date of said application for insurance, said insured had consulted and been treated by physicians for dizziness and fainting spells and for pain in the chest. That during the year 1942 and prior to the date of the application for said insurance, said insured, on numerous occasions, had consulted and been examined by a physician and had received treatments for angina pectoris, a disease of the heart. That during the year 1942 and prior to the date of the application for said policy of insurance, said insured had submitted to repeated physical examinations which included the taking of electrocardiograms and had been told by his physician that he was suffering from a heart ailment, to-wit, angina pectoris, and that he should curtail and limit his activities by reason thereof; that during the year 1942 and prior to the date of the application for said policy of insurance, said insured's physician had prescribed medicine to relieve pain in the chest suffered by insured as a result of said heart ailment. That all of the facts in this paragraph recited were concealed, and none of them was disclosed, in the application for said policy of insurance." [Finding No. XI, R. 52, 53.]

"That all of the facts concerning the health and medical history of said insured which were misrepresented and concealed in the application for said policy of insurance, as herein found, were known to the insured at the time said application was made and signed, and said facts were material to the risk insured against under the terms of said policy." [Finding No. XII, R. 53.]

"That it was, and is, provided by the terms of said policy of life insurance and of the application therefor that said policy should not take effect unless and

until said application should be approved by plaintiff at its home office and the first premium paid while the said insured was in good health. That said insured was not in good health at the time said policy was delivered, or at the time the first premium thereon was paid. That said insured knew, at the time said application for insurance was signed and delivered and at the time said policy was issued and delivered, and at the time the first premium thereon was paid, that he was not in good health, but that he was suffering from a serious disease of the heart, to-wit, angina pectoris." [Finding No. XIX, R. 56.]

### POINT I.

#### **Concealment or Misrepresentation of a Material Fact in an Application for Insurance Entitles the Insurer to Rescind, Regardless of Whether the Concealment or Misrepresentation Was Intentional or Unintentional.**

The policy in suit was applied for and delivered, and the premiums thereon were paid, in California. It is therefore a California contract, so that the substantive law of California is applicable and controlling.

*Equitable Life Assurance Society v. Pettus*, 140 U. S. 226, 11 S. Ct. 822, 35 L. Ed. 497;

*Gates v. General Casualty Co. of America*, 120 F. (2d) 925, 926;

*Palmquist v. Standard Accident Ins. Co.*, 3 F. Supp. 356, 357.

The California law is well settled that a false representation, or the concealment of a material fact, in an application for a policy of insurance, *whether intentional or unintentional*, vitiates the policy. Fraudulent intent is



not an essential element of a cause of action for rescission of an insurance contract.

*Gates v. General Casualty Co. of America*, 120 F. (2d) 925, 926;

*California Western States Life Ins. Co. v. Feinstein*, 15 Cal. (2d) 413, 101 P. (2d) 696;

*Telford v. New York Life Ins. Co.*, 9 Cal. (2d) 103, 69 P. (2d) 835;

*Maggini v. West Coast Life Ins. Co.*, 136 Cal. App. 472, 29 P. (2d) 263.

In *Telford v. New York Life Ins. Co.*, *supra*, the Supreme Court of California said:

“A false representation or a concealment of fact, whether intentional or unintentional, which is material to the risk vitiates the policy. The presence of an intent to deceive is not essential.”

In *Gates v. General Casualty Co. of America*, 120 F. (2d) 925, at page 927, this court stated and applied the same rule, quoting with approval from the decision in *Telford v. New York Life Ins. Co.*, *supra*.

The California Insurance Code, in the article headed “CONCEALMENT,” contains the following provisions:

“§330. Definition. Neglect to communicate that which a party knows, and ought to communicate, is concealment.

“§331. Effect. Concealment, whether intentional or unintentional, entitles the injured party to rescind insurance.”

The same code, in the article headed "REPRESENTATION," contains the following provisions:

"§358. Falsity. A representation is false when the facts fail to correspond with its assertions or stipulations.

"§359. Effect of falsity. If a representation is false in a material point, whether affirmative or promissory, the injured party is entitled to rescind the contract from the time the representation becomes false."

Appellant argues (1) that the insured was not a party to the insurance contract, (2) that the only contracting parties were appellee, as insurer, and appellant, as beneficiary and owner of the policy, and (3) that the policy does not provide, either expressly or by implication, that appellant's rights under the contract are dependent upon, or affected by, the conduct of the insured or the truth or falsity of the statements of the insured as contained in the application. Upon these premises, appellant predicates his argument that the contract in suit is not vitiated by any concealment or misrepresentation of facts in the application for the policy.

Appellee submits that appellant's argument is fallacious both in its premises and in its conclusion.

Part I of the application for the policy involved in this case was signed by appellant as "*Applicant for Insurance*," and by Abe Lutz as "*Proposed Insured*" [R. 405]. Immediately above the signatures of appellant and the insured, the following language appears upon Part I of the application:

*"It is Hereby Agreed that this Application, including Part II, a copy of which shall be attached to the*

*Policy when issued, shall become a part of every Policy issued hereon; \* \* \*."*

Under the heading "CONTRACT," the policy provides as follows:

*"This Policy and the application, a copy of which is attached to and made a part of this Policy, constitute the entire contract between the parties. All statements made by the Insured or in his behalf, in the absence of fraud, shall be deemed representations and not warranties; and no such statement shall be used in defense to a claim unless contained in the application and unless a copy of such application is attached to this Policy when issued. \* \* \*"* [R. 41.]

Moreover, on its first page, the policy recites that *"This Policy is issued in consideration of the application and of the annual premium \* \* \*."* [R. 39.]

By the plainest of language, the parties to the contract agreed that the application, including both Parts I and II, would be and become a part of the policy, and that *"all statements made by the Insured or in his behalf, in the absence of fraud, shall be deemed representations and not warranties."*

Appellant may deny the existence of a fraudulent intent on his part, but he cannot be heard to deny that the statements of the insured, as contained in the application, constituted representations. By the plain terms of the contract, appellant *adopted* as his own the statements of the insured, as set forth in the application, and agreed that they should be made a part of the contract. He further agreed that the statements of the insured should be deemed *representations*, or in the presence of fraud, *warranties*.

It is immaterial whether appellant or the insured *intended* to deceive or defraud the insurance company. It is sufficient to vitiate the policy if it be proved that a false or erroneous representation was made, either intentionally or unintentionally, as to any material fact (*Telford v. New York Life Ins. Co., supra*). The California statute plainly states that "*a representation is false when the facts fail to correspond with its assertions or stipulations.*" (*California Insurance Code, Sec. 358.*)

Clearly, the well supported findings of the District Court that matters of fact, material to the risk, were misrepresented and concealed in the application suffice to sustain the judgment under review.

## POINT II.

### Answers to Written Questions Set Forth in an Application for Insurance Constitute Material Representations as a Matter of Law.

The California law is well settled that answers to written questions set forth in application forms relative to insurance contracts are *deemed* material as a matter of law.

*California Western States etc. v. Feinstein*, 15 Cal. (2d) 413, 101 P. (2d) 696;

*Pierre v. Metropolitan Life Ins. Co.*, 22 Cal. App. (2d) 346, 70 P. (2d) 985;

*Inverson v. Metropolitan Life Ins. Co.*, 151 Cal. App. 746, 91 Pac. 609;

*Westphall v. Metropolitan Life Ins. Co.*, 27 Cal. App. 734, 151 Pac. 159;

*McEwen v. New York Life Ins. Co.*, 42 Cal. App. 133, 146, 183 Pac. 373;

*Maggini v. West Coast Life Ins. Co.*, 136 Cal. App. 472, 29 P. (2d) 263;

*Layton v. New York Life Ins. Co.*, 55 Cal. App. 202, 202 Pac. 958.

In *California Western States etc. Co. v. Feinstein, supra*, the California Supreme Court said:

“It has been held that answers to written questions set forth in application forms relative to insurance are generally *deemed* material representations.” (Citing many cases.)

In *Maggini v. West Coast Life Ins. Co., supra*, it was stated:

“The materiality of the representations cannot be doubted, these being in the form of written answers made to written questions which the parties themselves thus indicated they deemed material.”

In *Pierre v. Metropolitan Life Ins. Co., supra*, we find the following expressions:

“Answers to questions in an application are generally considered to be material representations of fact, which if false will vitiate the contract \* \* \* an answer to a question as to whether an applicant had ever had a specified disease is material and, if false, avoids the policy \* \* \*.”

The foregoing authorities clearly show that appellee's right to rescind was fully and completely established by proof that matters of fact relating to the health, physical condition and medical history of the insured were falsely represented in the application. In other words, the facts concealed and misrepresented by the insured in the instant case were, necessarily and as a matter of law, material.

### POINT III.

**The Policy in Suit Never Became Effective Because the Insured Was Not in Good Health When the Application for the Policy Was Approved and When the First Premium Thereon Was Paid.**

As we have seen, the District Court found, upon substantial and uncontradicted evidence, that the insured was not in good health at the time the application for the policy in suit was approved or at the time when the first premium was paid, but was suffering from a serious disease of the heart, to-wit, angina pectoris. This finding was supported by evidence that prior to the date of the application, the insured had suffered a stroke, and by the testimony of Dr. Rosenfeld that during the period from June 1, 1942, to December 9, 1942, the insured was suffering from arteriosclerosis and angina pectoris, diseases which were immediately contributing causes of the insured's death. Under these circumstances, the following provision of the contract is of decisive effect:

*“\* \* \* that the insurance applied for shall not take effect unless and until this Application is approved by the Company at its Home office and the first premium is paid while the Proposed Insured is in good health; \* \* \*.”*

Referring to an almost identical clause in deciding a case involving a factual situation strikingly similar to the case at bar, the Circuit Court of Appeals for the Eighth Circuit used the following language in *Gill v. Mutual Life Ins. Co. of N. Y.*, 63 F. (2d) 967, at page 970:

*“\* \* \* It is well settled that this clause in that contract, which provides that a policy shall not become effective unless delivered and received while the*

insured is in good health, is valid and will be enforced; \* \* \*."

The foregoing quotation is followed in the text by the citation of a long list of supporting decisions. (Accord, see 4 *Couch Cyclopedia of Insurance Law*, Sec. 860, p. 2828.)

The validity and effectiveness of similar provisions creating conditions precedent were sustained in:

*Stipcich v. Metropolitan Life Ins. Co.*, 277 U. S. 311, 48 S. Ct. 512, 72 L. Ed. 895;

*New York Life Ins. Co. v. Gist*, 63 F. (2d) 732, 735;

*Shaner v. West Coast Life Ins. Co.*, 73 F. (2d) 681, 685;

*Greenbaum v. Columbian National Life Ins. Co.*, 62 F. (2d) 56;

*Continental Illinois Natl. Bank & Trust Co. v. Columbian Natl. Life Ins. Co.*, 76 F. (2d) 733;

*Hurt v. New York Life Ins. Co.*, 51 F. (2d) 936;

*New York Life Ins. Co. v. Gay*, 36 F. (2d) 634, 636, 48 F. (2d) 595;

*Pierre v. Metropolitan Life Ins. Co.*, 22 Cal. App. (2d) 346, 70 P. (2d) 985;

*Security Life Ins. Co. v. Booms*, 31 Cal. App. 119, 159 Pac. 1000.

Whether the non-fulfillment of the condition precedent to the effectiveness of the policy be regarded as affording appellee an additional ground for rescission, or whether it be considered only as a defense to appellant's counterclaim seeking recovery on the contract, it is, in either aspect, independently sufficient to sustain the judgment under review.

#### POINT IV.

**Answers to Questions Propounded to the Proposed Insured in an Application for Insurance Are Representations Upon Which the Insurer Is Entitled to Rely, and the Insurer Is Under No Duty to Make an Investigation to Determine the Truth of Such Answers.**

Appellant here contends that since the application disclosed the name of a physician from whom appellee might have learned facts at variance with the representations of the application, appellee is estopped to rely upon such representations. In other words, appellant argues that appellee was under a duty to investigate and make inquiry in order to ascertain whether or not the statements of fact contained in the application were true.

A complete answer to appellant's arguments on this aspect of the case is to be found in the opinion of this court in *Gates v. General Casualty Co. of America*, 120 F. (2d) 925, which cites and quotes at length from the California decisions. It discusses and distinguishes the case of *Turner v. Redwood Mutual Life Assn.*, 13 Cal. App. (2d) 573, 57 P. (2d) 222, upon which appellant so strongly relies in the instant case.

The insufficiency of the matters relied upon by appellant to spell out waiver or estoppel is demonstrated by reference to the California decisions cited in *Gates v. General Casualty Co. of America*, *supra*, and particularly the following:

*Telford v. New York Life Ins. Co.*, 9 Cal. (2d) 103, 69 P. (2d) 835;

*Frederick v. Federal Life Ins. Co.*, 13 Cal. App. (2d) 585, 57 P. (2d) 235;

*Maggini v. West Coast Life Ins. Co.*, 136 Cal. App. 472, 29 P. (2d) 263.



In each of the cases last cited, facts were known to the insurer, at the time it acted upon the application involved, which tended to indicate incorrectness or incompleteness of certain answers therein contained. In each case, it was held that the insurer was not estopped to rescind upon discovering the falsity of material representations upon which it was entitled to rely. The following language from *Frederick v. Federal Life Ins. Co.*, *supra*, is particularly applicable:

“\* \* \* Even if it be considered that defendant upon receipt of the medical examiner’s report, had knowledge that, as regards the treatment by Dr. Woods, plaintiff had not fully answered the questions in the application, it does not follow that defendant cannot resist recovery on the policy on account of other and serious representations which defendant thereafter learned to be false. The application and report of the medical examiner were forwarded to company headquarters where the officials of defendant company decided whether they cared to issue the policy. It was their right to reject the application if upon the information before them they desired to do so. The fact that they might have overlooked or considered as inconsequential an incorrect or incomplete answer contained in the application does not prevent their defense against fraudulent statements, the falsity of which was discovered after the issuance of the policy. The defendant had no knowledge at the time the policy was issued of the misrepresentations now relied upon to defeat recovery.”

In *Maggini v. West Coast Life Ins. Co.*, 136 Cal. App. 472, 29 P. (2d) 263, the court stated:

“But the evidence is clear that the appellant did not have any knowledge of the falsity of any of these misrepresentations except that relating to the illness of the insured five years prior to the date of the policies. This may have been sufficient to raise a suspicion as to the truth of other representations relied on; but cause for suspicion does not constitute knowledge. Hence there could be no estoppel of the insurer’s right to ‘set up the fraud by way of defense to an action brought to enforce the apparent liability.’ (*California Reclamation Co. v. New Zealand Ins. Co.*, 23 Cal. App. 611, 615 (138 Pac. 960, 961); *General Accident, Fire & Life Assur. Corp. v. Industrial Acc. Com.*, 196 Cal. 179, 189, 190 (237 Pac. 33).)”

It is the well settled rule in California that the mere fact that a defrauded party may have had a means of acquiring knowledge of the truth does not debar recovery, there being no duty to investigate. The rule was recently stated in *Twining v. Thompson*, 68 Cal. App. (2d) 104, 156 P. (2d) 29, as follows:

“Where there is no legal duty of a plaintiff to investigate and no such circumstance is present as would put a reasonably prudent man upon inquiry, the mere fact that a means of acquiring knowledge is available to plaintiff and he has not made use of such means does not debar plaintiff from recovering after he makes the discovery. (*Tarke v. Bingham*, 123 Cal. 163, 166 (55 P. 759).) Innocent parties do not carry the burden of inquiry. (*Hart v. Walton*, 9 Cal. App. 502, 509 (99 P. 719).)”

Appellant offered no evidence whatsoever in the case at bar which proved, or tended to prove, that the insurer had knowledge of the falsity of any material representation concerning the health or medical history of the insured. The nearest approach to a circumstance which might have cast suspicion upon the completeness and truthfulness of insured's answers was the fact that appellee had information indicating that insured had, at some time or other, consulted a Dr. Lissner, who was an associate of Dr. Rosenfeld. It appears, however, that appellee had no knowledge concerning the date or the purpose of the supposed consultation with Dr. Lissner.

Appellant urges that appellee is estopped to assert that it relied upon the representations of the insured concerning his health and medical history by reason of the fact that Dr. Waste, the insurer's medical examiner, examined the insured and made a report indicating a favorable opinion as to his insurability. This contention is clearly without merit. In the first place, the requirement of medical examinations in connection with applications for life insurance is practically universal. In nearly every cited case dealing with concealment and misrepresentation in connection with an application for life insurance, it appears that the insured had submitted to a medical examination and that a report of such examination was received and considered by the insurer in connection with the application. It is manifest that such fact affords no basis for claim of waiver or estoppel.

In the second place, it is a matter of universal knowledge, affording a basis for judicial notice, that a great many serious diseases and ailments, including diseases of the heart and circulatory system, are latent, and may not be disclosed objectively even upon the most careful physi-

cal examination. Indeed, Dr. Waste so testified in this case [R. 223, 224]. It is in recognition of this obvious truth that the courts have uniformly held that insurance companies are entitled to receive full, complete and truthful answers from the insured concerning his health, medical history, past complaints and ailments.

### POINT V.

#### **There Can Be No Waiver of the Insurer's Right to Rescind Upon Grounds of Misrepresentation and Concealment Until After the Insurer Has Become Aware of the Falsity of the Representations.**

The defenses of estoppel and waiver asserted by appellant herein are closely related. Accordingly, the decision in *Gates v. General Casualty Co. of America*, 120 F. (2d) 925, and the cases therein cited are also pertinent to the defense of waiver.

It is, of course, well settled that a party asserting affirmative defenses of waiver and estoppel bears the burden of proving such defenses by clear and convincing evidence. (8 *Couch Cyclopedia of Insurance Law*, Sec. 2238, p. 7281.)

And in the case of *California Western States etc. Co. v. Feinstein*, 15 Cal. (2d) 413 at p. 422, 101 P. (2d) 696 at 701, it is stated:

“Nor may it be said that the insurer could have waived its right to rescind, on the ground of false representations made by the insured in his answers to the questions as set forth in the application for reinstatement, until the insurer had become aware of the falsity of those representations. (*McDanel v. General Ins. Co.*, *supra*; *Schick v. Equitable Life Assur. Soc.*, 15 Cal. App. (2d) 28, 34 (59 Pac. (2d)

163).) It was only after the insured had filed his claim for disability payments in June, 1936, at which time an investigation was made with regard to the ailments for which he had undergone treatment by a physician, that the falsity of the representations which the insured had made in the application for reinstatement was disclosed. On that state of the record it cannot be said that the insurer had waived any of the rights which it subsequently asserted against the insured."

In *Schick v. Equitable Life Assur. Soc.*, 15 Cal. App. (2d) 28, at page 34, the following from 67 C. J. 310, is quoted with approval:

"The evidence must show knowledge, at the time the waiver is claimed to have occurred, of all the material facts that would probably have influenced the conduct of the party; the proof must be clear that the party against whom the doctrine of waiver is invoked knew what his rights were. A waiver cannot be established by a consent given under a mistake of fact."

Appellant's affirmative defenses of waiver and estoppel necessarily failed because he did not sustain his burden of proving them and because the uncontradicted evidence established that the insurer received no knowledge or information whatever concerning the matters misrepresented and concealed until after investigation was made subsequent to the death of the insured. The insured's death occurring so soon after the issuance of the policy and from the causes indicated by the death certificate naturally suggested the propriety of such investigation.

## POINT VI.

**The Insured Having Executed an Express Waiver of the Physician-Patient Privilege, the Trial Court Did Not Err in Admitting the Testimony of Physicians Who Had Been Consulted by the Insured.**

Appellee submits that appellant's brief does not properly specify the errors relied upon in the manner required by Rule 20(d) of the rules of this court, especially with reference to alleged errors in the admission of evidence. Appellant has failed to quote either the grounds of objection urged at the trial or the substance of the evidence admitted. Moreover, the specifications of error are not limited to the scope of the statement of points served and filed pursuant to Rule 75(d) of the Federal Rules of Civil Procedure and set forth in the appendix to appellant's opening brief. Nevertheless, appellee will show that the contentions made by appellant are without merit.

The insurer called two physicians, who testified that they had been consulted by the insured prior to the date of the application for the policy in suit. The testimony of these witnesses proved, or tended to prove: (1) That prior to the date of the application, insured (a) had suffered from, and complained of, dizziness, nausea and pain in the chest, (b) had been taking nitroglycerine tablets prescribed for the relief of heart pain, (c) had suffered a slight stroke which had rendered him unable to rise from his bed for a week, (d) had submitted to numerous physical examinations in which electrocardiographs were taken; and (2) that from a time anterior to the application to the date of his death, insured had suffered from arteriosclerosis and angina pectoris, which were serious, chronic and progressive diseases of the circulatory system

and which contributed as immediate causes of insured's death.

Appellant argues that the trial court erred in overruling objections to this testimony made upon the ground that it related to privileged matters concerning which the physicians could not properly be examined by virtue of the provisions of Section 1881, subdivision (4) of the California Code of Civil Procedure. This statute provides in part that "a licensed physician or surgeon can not, *without the consent of his patient*, be examined in a civil action as to any information acquired in attending the patient, which was necessary to enable him to prescribe or act for the patient; \* \* \*." (Italics supplied.) The prohibition of the statute is subject to a number of qualifications and exceptions which need not be noted here.

It is undisputed in this case that the insured executed Part II of the application containing the following provision:

"\* \* \* I expressly waive to such extent as may be lawful, on behalf of myself and of any person who shall have or claim any interest in any policy issued hereunder, all provisions of law forbidding any physician or other person who has attended or examined me, or who may hereafter attend or examine me, from disclosing any knowledge or information which he thereby acquired, and I authorize any such disclosure."

By the quoted language, the consent of the *patient* was unequivocally given. It thus appears that *appellant*, as beneficiary of the policy in suit, sought to assert a privilege which was personal to the insured and which the

insured had expressly waived. It is well settled law that the privilege is effectively waived by a provision to that effect in an application for insurance.

8 *Wigmore on Evidence*, 3rd Ed., §2388, p. 831;

70 *Corpus Juris*, §633, p. 466;

27 *Cal. Jur.*, §43, p. 59;

*Wirthlin v. Mutual Life Ins. Co.*, 56 F. (2d) 137;

*Lincoln National Life Ins. Co. v. Hammer*, 41 F. (2d) 12;

*New York Life Ins. Co. v. Renault*, 11 F. (2d) 281.

*Wigmore* expresses the rule as follows:

“(b) An *express waiver by contract*, *e. g.*, in a policy of insurance, may be given effect, on the general principle already noticed in §7a. Since experience has shown that the testimony of physicians who might assist the discovery of the truth is likely to be suppressed by the insured’s claim of privilege, and since the contract of insurance is a voluntary transaction for both parties, the insurer’s insistence on a provision of this sort in his contract is no more than a reasonable measure of self-protection, and does not affect the interest of patients in general other than the insured party to the contract.”

Appellant apparently does not deny the validity or the effectiveness of an express waiver of the privilege such as was signed by the insured in this case. No decision cited by appellant holds or intimates that such a waiver is not valid and effective.



However, it appears to be appellant's contention that the insured's express waiver of the privilege became an integral part of the contract, and that the insurer's rescission of the contract operated to destroy the effectiveness of the waiver.

This novel and ingenious argument lacks the support of reason or authority. The rule that a party may not rescind a contract and, at the same time, claim benefits under it has no application here. Appellee seeks no benefit and asserts no substantive right which is not entirely consistent with its rescission and repudiation of the contract.

Rather, it is appellant who, with obvious inconsistency, has sought to *recover* upon the contract and, at the same time, to repudiate a waiver which he, himself, describes as an "integral part" of the contract.

We are dealing here, not with a rule of substantive law, but with a rule of evidence. Under the provisions of Rule 43(a) of the Federal Rules of Civil Procedure, "*the statute or rule which favors the reception of evidence governs,*" and it is important to note the further provision of the rule that "*the competency of a witness to testify shall be determined in like manner.*"

Manifestly, the testimony of these physicians concerning their observations of the insured, their objective findings and their diagnoses was not hearsay. The declarations of the insured concerning his pains, complaints and suffering not only were a part of the *res gestae*, but also

were admissible under another recognized exception to the hearsay rule which is stated by *Wigmore* as follows:

“It is for statements of physical pain or suffering that the exception has been longest recognized and the principle most fully and clearly reasoned out.” (*Wigmore on Evidence* (3rd Ed.), Vol. VI, Secs. 17, 18, p. 63.)

Moreover, the insured's declarations were admissible to prove his knowledge of material facts concerning his health, which facts were fully established by other evidence. (*Missouri State Life Ins. Co. v. Young*, 38 F. (2d) 399; *Wigmore on Evidence* (3rd Ed.), Vol. II, Sec. 266(a), p. 91.)

Indeed, appellant limited his objections to disclosures made subsequent to the date of the application [R. 100], recognizing the admissibility of declarations and disclosures anterior thereto. Furthermore, the record shows that appellant, himself, expressly and in writing, authorized the disclosure of all the information which he now claims was privileged [R. 403, 404]. The record further shows that these authorizations executed by appellant were received by third parties and were used to obtain all of the information which appellant claims to be privileged [R. 231 *et seq.*; also, 240 *et seq.*]. Under these circumstances, appellant is estopped to assert any objection to the testimony of these physicians on the ground of privilege.

*Estate of Visaxis*, 95 Cal. App. 617, 273 Pac. 165.

## POINT VII.

### Appellant Has Wholly Failed to Sustain His Burden of Showing Error in the Findings of the District Court.

Appellant, of course, carries the burden of showing this appellate court that the findings of the District Court are clearly erroneous.

F. R. C. P., Rule 52(a);

*Augustine v. Bowles*, 149 F. (2d) 93, 96;

*Gates v. General Casualty Co. of America*, 120 F. (2d) 925, 929.

Appellee has shown by reference to the record that every finding of the trial court is supported by an abundance of substantial evidence. Indeed, the findings that material facts were falsely represented and concealed and the finding that insured was not in good health were required by uncontradicted evidence.

Appellant has not challenged either the admissibility or the reliability of the testimony of the witness Ludden, the pharmacist who, on June 1, 1942, filled (and many times afterward refilled) the prescription for nitroglycerine tablets which were to be taken for "heart pain" [R. 401].

The uncontradicted testimony of the pharmacist that the insured complained of pain in his chest and desired the prescription "*as soon as possible*" [R. 88] sufficed to prove the falsity of the material representation in the application that insured had never suffered from pain or pressure in the chest. The fact that insured was taking

medicine for the relief of heart pains and submitting to repeated examinations and electrocardiographic studies proved, beyond all reasonable doubt, that he knew of his condition.

### Conclusion.

Appellee submits that the judgment under review is sustained by well settled rules of law, and that appellant has failed entirely to show error in any particular. Therefore, the judgment should be affirmed.

Respectfully submitted,

MESERVE, MUMPER & HUGHES,

ROY L. HERNDON,

*Attorneys for Appellee.*

No. 11180

IN THE

# United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

---

HARRY LUTZ and HARRY LUTZ and ROSE LUTZ, as executor and executrix of the last will and testament of Abe Lutz, Deceased,

*Appellants,*

*vs.*

NEW ENGLAND MUTUAL LIFE INSURANCE COMPANY OF  
BOSTON, a corporation,

*Appellee.*

---

## APPELLANT'S REPLY BRIEF.

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APR - 6 1946

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No. 11180

IN THE

# United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

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HARRY LUTZ and HARRY LUTZ and ROSE LUTZ, as executor and executrix of the last will and testament of Abe Lutz, Deceased,

*Appellants,*

*vs.*

NEW ENGLAND MUTUAL LIFE INSURANCE COMPANY OF BOSTON, a corporation,

*Appellee.*

---

## APPELLANT'S REPLY BRIEF.

---

Appellee's brief attempts to obscure the controlling elements of this case and requires no reply other than a correction of some of the misapprehensions created therein. Appellant's Opening Brief is otherwise ample answer, and he will not incumber the record by its reiteration.

Summarizing, Appellant will confine himself, in this reply, to the following points:

1. There is no issue in this case with respect to Question 29 of Part II.
2. The California Insurance Code imposes upon the "insurer" *the duty of making investigation* of that which

it has "the means of ascertaining" and which "in the exercise of ordinary care" it "ought to know." It is "presumed" and "bound to know" that which is "equally" open to its "inquiry." Its right to information of the material facts is "waived" by its "neglect to make inquiries as to such facts," particularly "where they are distinctly implied in other facts of which information is communicated."

3. No false representation was made and nothing was concealed from appellee.

4. Appellant, neither in fact nor in legal contemplation, adopted "as his own" the statements of Abe Lutz in Part II.

5. Appellee cannot have its cake and eat it too.

6. Appellee concedes that the testimony of attending physicians of Abe Lutz with respect to the latter's statements to said physicians, including all subjective symptoms, were hearsay as to appellant.

7. The defenses of waiver and estoppel compel reversal of the trial court's judgment.

I.

**There Is No Issue in This Case With Respect to  
Question 29 of Part II.**

Appellee has injected a false issue in this case. Appellee's amended complaint does not allege that the whole or any part of the answer of the "insured" to question 29 in Part II (requesting full description of illnesses, diseases or injuries and since childhood) contains either any concealment or any false representation [I, 2, 17].

The issues in this connection are tendered by Paragraph IX of the amended complaint [I, 6, 9] and are joined, without aid of said complaint, by Paragraph IX of Appellant's answer [I, 24-26].

While said complaint alleges that Abe Lutz, the so-called "insured," gave and stated all the answers to all the questions in said Part II with intent to deceive appellee "in answer to *certain* of the questions" (emphasis added), nevertheless, said complaint identifies said "*certain* of the questions" with a particularity which excludes said question 29 of said Part II.

Said complaint alleges, and there is no aid thereof in appellant's answer, that the alleged false representations and concealment relied upon by appellee to vitiate the policy are with respect to *only* questions 35, 36 and 44 [I, 8, 9].

This is emphasized by Paragraph X of said complaint [I, 9-10], which alleges that appellee did not know that

“said representations” and “said answers” were false and untrue and that had it known

“that within *one* year preceding the date of said application for said insurance, said Abe Lutz [appellant’s father, the so-called “insured”] had consulted a physician and been treated by a physician for *pains in the chest, dizziness, shortness of breath and palpitation of the heart*, and had plaintiff known that Abe Lutz had in fact *suffered from dizziness and fainting spells, palpitation of the heart, shortness of breath, pains and pressure in the chest*, it would not have issued said policy of life insurance.” (Emphasis added.) etc.

This is again demonstrated in Paragraph XIII of said complaint [I, 11-13] which alleges, in so far as is here pertinent, that “after the death of said Abe Lutz \* \* \*, and \* \* \* receipt \* \* \* of proofs of death \* \* \*, plaintiff \* \* \* first \* \* \* received information leading it to \* \* \* an investigation \* \* \* to determine whether said answers were true, \* \* \*

“That as a result of said investigation and examinations plaintiff company first learned that \* \* \* said Abe Lutz had, prior to the date of said application for said insurance, suffered from, had consulted a physician for, and been examined by a physician for indigestion, dizziness and fainting spells, palpitation of the heart, shortness of the breath and pains and pressure in the chest and had, within approximately one year prior to the date of said application and other than in August, 1942, consulted a physician and been treated by a physician for, and had suffered from each and all of the ailments hereinabove *particularly described* and alleged.” (Emphasis added.)

### The Issues.

In this connection, the amended complaint alleges, and appellant's answer denies that his father, Abe Lutz:

A. In or by his answers in his medical examination referred to in the application (part 1) for insurance as "Part 2," falsely or fraudulently represented to appellee that he:

1. Had never suffered from:

- (a) Indigestion;
- (b) Insomnia;
- (c) Nervous strain or depression;
- (d) Overwork;
- (e) Dizziness or fainting spells;
- (f) Palpitation of the heart;
- (g) Shortness of breath;
- (h) Pain or pressure in the chest.

2. Had not consulted or been treated or examined by any physician or practitioner other than Dr. Maurice H. Rosenfeld in August, 1942, and for a physical examination and blood sugar determination, with normal result, *within five years* immediately preceding November 14, 1942, the date of said application.

B. Falsely or fraudulently concealed the fact that he had consulted and been treated by physicians:

1. Within *five years* prior to November 14, 1942, the date of said application, for:

- (a) Dizziness or fainting spells;
- (b) Palpitation of the heart;
- (c) Shortness of breath;
- (d) Pain or pressure in the chest.

2. In January, 1937, for nausea and dizziness;
3. In June, 1942, for pains in the chest;
4. In July, 1942, for
  - (a) Dizziness or nausea;
  - (b) Pains in the chest;
  - (c) Indigestion;
  - (d) Palpitation of the heart;
  - (e) Various ailments and diseases.

It will be noted that "various ailments and diseases" last above mentioned as subdivision "(e)," although broad and comprehensive to infinity, is, nevertheless, limited to the month of *July, 1942*, during which month, as will be hereinafter disclosed, Abe Lutz saw only one doctor, Dr. Rosenfeld, and saw him only once, to wit, on July 6, 1942, with no complaints whatsoever [I, 115]. Even on this date, July 6, 1942, the doctor had made no definite diagnosis of any ailment or disease and certainly no diagnosis of any heart condition, and in his private thinking with respect to Abe Lutz' condition, only had suspicions; he "suspected the possibility" of a heart condition [I, 116] but he did not tell Abe Lutz what he "suspected" nor what his conclusions were [I, 117], explaining that his conclusions based on his suspicions were "just for my own information and a follow-up for further diagnostic evidence" [I, 117].



Duodenal Ulcer, Coronary Thrombosis, and the "Tentative" "Suspicion" of Dr. Rosenfeld That It Was "Probable" That Abe Lutz Had Mild Angina Pectoris Have No Relevancy, and Are Foreign, to Any Issue in This Case.

#### DUODENAL ULCER:

Just before Abe Lutz died, "he was sent to the hospital because he had an acute duodenal ulcer; that is, an ulcer of the stomach" [I, 120]. Duodenal ulcer was one of the contributing causes of death [II, 420]. Appellant's father had been afflicted with said duodenal ulcer slightly over two months prior to his death [II, 420]. In other words, the insured did not become so afflicted until well over a year after the effective date of the policy. He did not have such an ulcer when the application was signed [II, 420].

#### CORONARY THROMBOSIS:

This was the "*immediate contributing*" cause of the death of Abe Lutz [I, 119]. Appellant's father was so fatally stricken *only* "several hours" or "immediately preceding his death" [I, 143]. According to the death certificate, Abe Lutz had been so afflicted one day [II, 420]. In other words, Abe Lutz did not acquire this affliction until well over nineteen months after the effective date of the policy. Dr. Rosenfeld, the sole author of this diagnosis, testified that normal, healthy appearing people suffer from *fatal* attacks of coronary thrombosis without any previous symptoms thereof [I, 143], and that in all of the examinations that he, Abe Lutz' attending physician, made, from the first time Abe Lutz became his patient up until the fatal attack (a period of over 7 years, *i. e.*,

from 1-16-37 to 5-28-44), there were no symptoms, subjective or objective, which could be ascribed to coronary thrombosis [I, 144]. In short, Abe Lutz did not have coronary thrombosis when the application was signed on November 14, 1942.

ANGINA PECTORIS, OR "MILD ANGINA PECTORIS":

This is irrelevant and foreign to any issue in this case for at least four reasons, to wit:

1. As elaborated in points "(a)" and "(b)," pages 21 to 28 of appellant's opening brief, Abe Lutz the socalled "insured" is not a party to the contract of insurance and neither the policy nor the law provide that appellant's rights in the premises are predicated upon the conduct of the insured.

2. Neither any alleged falsity nor any alleged concealment in the answers of Abe Lutz to question 29 in Part II (requesting full description of ailments, diseases or injuries had since childhood) is in issue in this case as is hereinabove explained.

3. There is no evidence in the record that as of any date subsequent to August 11, 1942 (over three months prior to the date of the application) and prior to April 7, 1944 (when Dr. Rosenfeld next saw Abe Lutz after August 11, 1942), there was any diagnosis, qualified or unqualified, or either angina pectoris or "mild angina pectoris." While, over appellant's objection [I, 122-123], Dr. Rosenfeld stated that it was his "belief," *in retrospect*, that Abe Lutz had angina pectoris during the period between November 1, 1942 and December 9, 1942 [I, 122-123], nevertheless, he neither saw Abe Lutz nor prescribed any

medicine for him during the entire period of over nineteen months between August 11, 1942, and April 7, 1944 [I, 143-144]. Further, the above mentioned testimony of Dr. Rosenfeld, made *in retrospect*ion, after the death of said Abe Lutz, should have been, and the trial court thought that it was excluded and expunged from the record as is demonstrated by the statement of the court to that effect in the court's opinion where, speaking of evidence elicited from Dr. Rosenfeld, Judge Jenny said:

“The testimony limits the information obtained by Dr. Rosenfeld from the deceased (Abe Lutz) to that period of time prior to November 16, 1942.” [I, 355.]

Inasmuch as there is no competent evidence with respect to any unfavorable state of the health of Abe Lutz when the application was *approved* and the first premium thereon was *paid*, it therefore follows that the *after death* diagnosis of angina pectoris is irrelevant and foreign to appellee's claim that when the application was approved and the first premium thereon was paid that Abe Lutz was not in good health.

4. There was no diagnosis of angina pectoris until after the death of Abe Lutz [II, 420]. Dr. Rosenfeld, the sole author of that *ultimate* diagnosis, first acquired “suspicions” that Abe Lutz had “mild angina pectoris” on June 1, 1942; the symptoms “were very mild” [I, 136]. Angina pectoris was only “suspected” [I, 107], and it was Dr. Rosenfeld's policy not to make any statements which would make the patient unduly apprehensive when he found a

condition involving a *suspicion* of heart infirmity [I, 119, 135], and in lieu thereof he told Abe Lutz about the latter's "potential diabetic condition" [I, 107] and prescribed nitroglycerine [I, 106], sometimes prescribed for high blood pressure [I, 135], for relief of the pain of the *suspected* mild angina pectoris [I, 106, 137] and advised curtailment of activities and reduction of weight by diet "to improve this potential diabetic condition" [I, 106, 137]. The doctor's *unrevealed* "suspicions" on June 1, 1942, were tentative only [I, 137]. Those suspicions were "*probably* angina pectoris, *probably* due to the coronary artery narrowing," which latter narrowing, the doctor thought, was "*probably* progressive" [I, 106] (The emphasis on the three appearances of the word "probably" in the two phrases last above quoted is of course added). Based on "very mild" symptoms [I, 136] and *probabilities*, the doctor only had "tentative" "suspicions" of "mild angina pectoris." Even this tentative *suspicion* the doctor did not reveal to Abe Lutz, who was merely reminded by the doctor "to improve this potential diabetic condition" [I, 106, 137].

Even as late as July 6, 1942, the fourth time Abe Lutz was seen by Dr. Rosenfeld after June 1, 1942, the doctor reserved any diagnosis, and in answer to the question

"On July 6, 1942, did you tell the patient what your diagnosis and conclusions were?"

he answered,

"No, sir, that was just for my own information and a followup for further diagnostic evidence" [I, 117].

Dr. Rosenfeld merely revealed his "suspicion" [I, 117]. Dr. Rosenfeld then explained that it was possible for a person to have mild angina pectoris and thereafter effect a *complete recovery*, and that many times a person will have all the symptoms and, over a period of time and treatment, effect a complete recovery [I, 149].

On August 7, 1942, the next visit of Abe Lutz to Dr. Rosenfeld, Mr. Lutz had no complaints. "The examination and the discussion on that day was primarily referable to the patient's diabetic problem." Mr. Lutz was told "that his blood sugar was essentially normal" [I, 118].

On August 11, 1942, the next visit of Abe Lutz with Dr. Rosenfeld and the last time the doctor saw Mr. Lutz before April 7, 1944 when the latter was stricken with his fatal illness [I, 144], Mr. Lutz had no complaints. The doctor testified that although his *suspicion* was the same, nevertheless "there was no increase in impairment" [I, 118]. It is to be noted that even on this late date there was still no definite diagnosis or certainty of Abe Lutz' affliction which the doctor, even on this last visit prior to the fatal illness of Abe Lutz, referred to as "the condition I suspected" [I, 118]. Additionally, Dr. Rosenfeld testified, the over-all picture was that the patient was improving; he was better; he had improved [I, 141]. Mr. Lutz had recovered from the pain [I, 150]. His appearance was that of a normal appearing man in every way [I, 144].

The first and only diagnosis of angina pectoris is the one made by Dr. Rosenfeld after the death of

Abe Lutz, when, in retrospection and realization that “an acute coronary thrombosis” was “the immediate contributing cause” of the patient’s death [I, 119], he signed the certificate of death [II, 420].

The *unalleged*, but now, by appellee, claimed concealment of affliction with angina pectoris, or “mild angina pectoris,” is not an issue in this case because when Part II was signed no one was competent to determine the fact as to whether Abe Lutz was so afflicted, other than a medical expert, Dr. Rosenfeld in the instant case, and with him, even in his own private thinking, said affliction was not a fact and remained only a *suspicion* until death by reason of another affliction, to wit, coronary thrombosis, as the “immediate contributing” cause, occurred.

It is pertinent, at this point, to point out the fact that under the law even a *party* to a contract of insurance is not bound to communicate to the other, *even upon inquiry*, information of his own *judgment* upon the matters in question. We refer to and quote California Insurance Code, Sec. 339, to wit:

*“Information of party’s own judgment.*  
Neither party to a contract of insurance is bound to communicate, *even upon inquiry*, information of his own judgment upon the matters in question.” (Emphasis added.)

*California Insurance Code, Sec. 339.*

It is unfair, after the lips of Abe Lutz are sealed by death, and it would offend all principles of equity, to assert that Abe Lutz concealed affliction with angina pectoris (which he did not *know* that he had,

*hoped* and *prayed* that he did not have, and *tried* to avoid by following the best medical advice he could secure) when he was constrained to rely and depend upon expert medical advice for diagnosis and such expert medical advice (to wit, that of Dr. Rosenfeld, a heart specialist), in lieu of diagnosis, had and furnished only "tentative" judgment of "suspicions" or "probability."

## II.

The California Insurance Code Imposes Upon the "Insurer" the Duty of Making Investigation of That Which It Has "the Means of Ascertaining" and Which "in the Exercise of Ordinary Care" It "Ought to Know." It Is "Presumed" and "Bound to Know" That Which Is "Equally" Open to Its "Inquiry." Its Right to Information of the Material Facts Is "Waived" by Its "Neglect to Make Inquiries as to Such Facts," Particularly "Where They Are Distinctly Implied in Other Facts of Which Information Is Communicated."

Appellee, at page 22 of its brief, urges that it was under no legal duty to investigate. It makes this argument by incongruous analogy to *Twining v. Thompson*, 68 Cal. App. (2d) 104, which is not an insurance case, and to the contrary involves a long unapprehended fraud of a fiduciary and the court in that case merely held, as to the trusting and unsuspecting plaintiff partner who was defrauded, that "\* \* \* the mere fact that a means of acquiring knowledge is available to plaintiff and he has not made use of such means does not," in that character of situation, "debar plaintiff from recovering after he makes

the discovery. \* \* \* Innocent parties do not carry the burden of inquiry. \* \* \*.”

The difference in the relation between the (“applicant for”) purchaser of insurance and the (“insurer”) vendor thereof, on the one hand, and, on the other, the fiduciary relationship between copartners (as is involved in the *Twining v. Thompson* case, *supra*, from which appellee’s inappropriate and misleading above mentioned quotation is taken), is obvious. The law with respect to *investigative* duty is not the same in the situation present in this case which involves the “applicant for insurance” (appellant) and the “insurer” (appellee), as it is as between copartners who are fiduciaries as to each other and thus are not dealing “at arm’s length.” It is obvious that appellee is totally without authority in support of its argument in this connection by reason of its having cited and quoted an excerpt from such an inappropriate reference as is the *Twining* case, *supra*.

In addition to the case law on the subject, a statutory duty of investigation is imposed upon the insurer by California Insurance Code, Sections 332, 333, 334 and 336, as follows:

By No. 332, entitled “Required Disclosures,” the insurer must investigate, *i. e.*, ascertain, “all facts” which it has “the means of ascertaining” inasmuch as the other party to the insurance contract, the *applicant for insurance* (appellant), is only required to communicate to the *insurer* such material facts “within his knowledge” as to which he makes no warranty and which the insurer

“has not the means of ascertaining.” (Emphasis added.)



Adding emphasis, we quote *California Insurance Code*, Section 332, in full as follows:

*“Required Disclosures.* Each party to a contract of insurance shall communicate to the other, in good faith, all facts *within his knowledge* which are or which he believes to be material to the contract and as to which he makes no warranty, *and which the other has not the means of ascertaining.*”

332 *California Insurance Code.*

NOTE:

Abe Lutz' waiver of privilege and express authorization for full disclosure invested the appellee "insurer" with "the means of ascertaining" all facts which it now claims were concealed from and misrepresented to it.

By Section 333, entitled "Matters Not Required to Be Disclosed Except Upon Inquiry," the *applicant for insurance* (appellant), except in answer to the inquiries of the *insurer* (appellee), is not bound to communicate information of matters which, in the exercise of ordinary care, the *insurer* ought to know or as to which the *insurer* "waives communication." Adding emphasis, we quote in part *California Insurance Code*, Section 333, as follows:

"Matters Not Required to Be Disclosed Except Upon Inquiry. Neither party to a contract of insurance is bound to communicate information of the matters following, except in answer to the inquiries of the other:

1. Those which the other knows.
2. Those which, *in the exercise of ordinary care*, the other *ought to know*, and of which the party has no reason to suppose him ignorant.
3. Those of which the other waives communication

4. \* \* \*

5. \* \* \*.”

333 *California Insurance Code.*

By Section 335, entitled “Presumed Knowledge,” the *insurer* (appellee) is “bound to know” all the matters which may affect the perils contemplated, and which are “open” to its inquiry “equally” with that of the *applicant for insurance* (appellant). Adding emphasis, we quote in part *California Insurance Code*, Section 335 as follows:

“Presumed Knowledge. Each party to a contract of insurance is *bound to know*:

(a) All the general causes which are *open to his inquiry equally with that of the other*, and which may affect either the political or material perils contemplated.

(b) \* \* \*.”

335 *California Insurance Code.*

NOTE:

It should here be observed that the matters allegedly misrepresented as well as those allegedly concealed by Abe Lutz (there is no allegation that appellant misrepresented or concealed anything) were open to the *insurer's* (appellee's) “inquiry equally with that of” the *applicant for insurance* (appellant). In fact, such matters were more open to *insurer's* (appellee's) inquiry inasmuch as appellee was (and appellant was not) armed and implemented with Abe Lutz' said waiver of privilege and express authorization for full disclosure, and the name and address of Dr. Maurice H. Rosenfeld.

By Section 336, entitled "Waiver of Right to Information," the *insurer* (appellee) "waived" its "right to information of material facts" which it claims were concealed from it by its "neglect to make inquiries as to such facts," particularly as is true in the instant case at bar, where such facts were "distinctly implied in other facts of which information [was] communicated." Adding emphasis, we quote in part *California Insurance Code*, Section 336, as follows:

"Waiver of Right to Information. The *right* to information of material facts may be *waived* \* \* \* *by neglect to make inquiries* as to such facts, where they are distinctly implied in other facts of which information is communicated."

336 *California Insurance Code*.

NOTE:

All "information of material facts" which appellee claims was concealed from or misrepresented to it was "distinctly implied" in the following "other facts of which information" was "communicated" to appellee:

1. That Abe Lutz had:

- (a) been declined for insurance. [Question 28 of Part II; I, 44; II, 406];
- (b) been suspected of having sugar or albumen in his urine [Question 37 of Part II; I, 44; II, 406];
- (c) lost 15 pounds in weight in then recent months [Question 32 of Part II; I, 44; II, 406];
- (d) consulted and had physical examination by Dr. Maurice H. Rosenfeld of 1908 Wilshire Blvd. in Los Angeles during the then preceding August, 1942, then less than three months earlier [Question 36 of Part II; I, 44; II, 406];

2. That Dr. Rosenfeld was a heart specialist and checked Abe Lutz' heart [I, 218];

3. That Abe Lutz had a history of diabetes [I, 216];

4. That Abe Lutz had been rejected for insurance on account of sugar in his urine [I, 216];

5. That appellee's medical examiner had examined Abe Lutz several times previously [I, 216].

Knowing that Dr. Rosenfeld was a heart specialist, that he had checked Abe Lutz' heart and given him a physical examination, together with a blood sugar determination, together with Abe Lutz having been declined for insurance on account of sugar in his urine, and having a history of diabetes, "distinctly implied" that Dr. Rosenfeld was in possession of information of facts material to a proper determination of the physical condition of Abe Lutz which also implied that Dr. Rosenfeld had properly taken a history from Abe Lutz. All "information of material facts" which appellee claims was concealed from or misrepresented to it were ultimately elicited from Dr. Rosenfeld. Even the information elicited from Dr. Seech, over appellant's objection upon the trial of this case, was known to Dr. Rosenfeld.

It follows therefore by the provisions of *California Insurance Code*, Sec. 336, that appellee "waived" its "right to information of material facts" which it claims were concealed from it, by its "neglect to make inquiries as to such facts" inasmuch as such facts were "distinctly implied" in other facts of which information was "communicated" to it.

*California Insurance Code*, Sec. 336.

III.

**No False Representation Was Made and Nothing  
Was Concealed From Appellee.**

Ample treatment of this point is contained in appellant's opening brief and particularly under subdivision "(h)" thereof, pages 53 to 61 both inclusive, to which reference merely is made to avoid reiteration. Additionally, however, it should be observed that "concealment" is defined by California Insurance Code, Sec. 330, as

neglect to communicate that which a party *knows* and *ought to communicate*.

Further, appellant was not under any duty to disclose any facts which appellee had "the means of ascertaining,"

*California Insurance Code, Sec. 332.*

or, except in answer to specific inquiry, any facts which "in the exercise of ordinary care" appellee ought to have known or ascertained,

*California Insurance Code, Sec. 333*

or, any facts concerning information to which appellee waived its right by its "neglect" to make inquiry.

*California Insurance Code, Sec. 336.*

There were no false representations as is clearly demonstrated in the above mentioned subdivision of appellant's opening brief, mere reference to which is again made to avoid reiteration.

The above mentioned Insurance Code sections are relatively well amalgamated into succinct form in the case of

*Columbia Nat'l Life Ins. Co. v. Rodgers*, 116 F. (2d) 705, 707, where it is said that:

“An insurance company may be charged with knowledge of facts which it ought to have known. See, *Supreme Lodge K. P. v. Kalinski*, 163 U. S. 289, 16 S. Ct. 1047, 41 L. Ed. 163. Knowledge which is sufficient to lead a prudent person to inquire about the matter, when it could have been ascertained conveniently, constitutes notice of whatever the inquiry would have disclosed.”

#### IV.

**Appellant, Neither in Fact Nor in Legal Contemplation, Adopted “As His Own” the Statements of Abe Lutz in Part II.**

Appellee grudgingly concedes that the only parties to the insurance contract involved in this case are appellee, as the “insurer,” and appellant, as the *assured*. Obviously the deceased Abe Lutz, as the so-called “insured,” *waived* certain rights (when he signed the waiver of privilege and express authorization for full disclosure), but in so doing he acquired no rights. Abe Lutz appears in this transaction as simply the *life* (not the individual) insured, *i. e.*, the contract or policy was “*about*” him but not “*with*” him. His death merely furnished the contingency upon which the liability of the *appellee* insurer to the assured *appellant* was made to depend.

Appellee apparently concedes this, or at least makes no argument and cites no authority to the contrary. Appellee seeks to cover its default on this issue by argument supported by neither authority nor logic, that appellant (on

11-14-42) adopted as his own the (11-16-42) statements of Abe Lutz in Part II because:

1. The policy provides that "all statements made by the insured or in his behalf, in the absence of fraud, shall be deemed representations and not warranties"; and

2. Appellant, in signing the application (Part I) on November 14, 1942 (2 days before Abe Lutz, as the only signer thereof, signed Part II on November 16, 1942), agreed that Part II (then in blank and unsigned) should "become a part of every policy issued" on said application (Part I).

This argument, if it may be called "argument," involves a *non-sequitur*. No one would claim that appellant *adopted as his own* the statements of Charles Dickens if the application (Part I) had contained an agreement that Charles Dickens' Christmas Carol should become a part of every policy issued on said application (Part I). In further illustration of that which we submit is an illogical conclusion which appellee seeks to establish in this connection, it may be further observed that if the policy had provided that all statements made by Charles Dickens or in his behalf, in the absence of fraud, should be deemed representations and not warranties, the fact would remain that whether the statements were representations or warranties they would nonetheless be the representations or warranties of Charles Dickens and not the representations or warranties of the applicant for insurance.

No where in the application, and no where in the policy is there any provision whereby appellant adopts the statements of Abe Lutz as his own statements. There is no evidence in the record to even indicate that appellant had

any personal knowledge of any material fact falsely stated to or concealed from appellee. Neither the contract of insurance nor the law provides that the policy can be vitiated by appellee by reason of the false representations or the concealment of any one who is not a party to the contract of insurance.

No where in the law can be found any principle of either law or equity which provides that, in the absence of express agreement, contracting parties as between themselves will be bound or their contractual relationship be affected by the statements, warranties, representations, or conduct of any non-contracting party or parties. Certainly, in the case at bar, appellant has found no principle of law or equity, and appellee has cited none, which assert that under facts such as those in the instant case appellant, as a matter of law, is deemed to have adopted as his own the statements of Abe Lutz contained in said Part II.

## V.

### **Appellee Cannot Have Its Cake and Eat It Too.**

Appellee continues to stand on the insurance contract in suit simultaneously repudiating it. It continues to urge that the express waiver of privilege signed by Abe Lutz became an integral part of the contract of insurance which it has, in and by *its* action in the instant case, sought to and succeeded, to date, in cancelling, rescinding and repudiating as *void*. In its brief it even seeks to justify its inclusion of the express waiver in the insurance contract by a quotation from *Wigmore* which, in part, is as follows:

“\* \* \* Since the contract of insurance is a voluntary transaction for both parties, the insurer’s insist-



ence on a provision of this sort in his contract is no more than a reasonable measure of self protection.

\* \* \*.”

Without citation of authority, appellee then proceeds to try to “brush off” by characterizing as “novel and ingenious” appellant’s quotation (at page 34 of its opening brief) from *Grant v. Sun Indemnity Co.* (1938), 11 Cal. (2d) 438, 440, to wit:

“The insurer may not repudiate the policy, deny all liability, and at the same time be permitted to stand on a provision inserted in the policy for its benefit.”

It is respectfully submitted that after appellee has made the waiver a part of and it has become merged into the contract of insurance by the very terms of the contract, appellee, as the insurer, may not repudiate the policy, deny all liability thereunder, and at the same time stand, or be permitted to stand, on any provision inserted therein for its benefit.

*Austin v. Hallmark Oil Co.* (1943), 21 Cal. (2d) 718, 727 (5);

*Grant v. Sun Indemnity Co.* (1938), 11 Cal. (2d) 438, 440.

VI.

**Appellee Concedes That the Testimony of Attending Physicians of Abe Lutz With Respect to the Latter's Statements to Said Physicians, Including All Subjective Symptoms, Were Hearsay as to Appellant.**

Appellee concedes that the complaints and statements of Abe Lutz to his attending physicians, Drs. Rosenfeld and Seech, including all subjective symptoms, were hearsay as to appellant. Appellee merely urges, at page 29 of its brief, that:

“\* \* \* the testimony of these physicians concerning their observations of the insured, their objective findings and their diagnosis was not hearsay.”

Appellee confirms its concession that hearsay was erroneously admitted in this case by asserting, without citation of authority, that the statements of Abe Lutz to his attending physicians as to his history, complaints and symptoms, were a part of the *res gestae*. Appellee does cite and quote from *Wigmore* in this connection, but only to the effect that exclamations of physical pain which do constitute a part of the *res gestae* constitute the oldest and “most fully and clearly reasoned out” exception to the hearsay rule.

All of the facts which appellee claims were falsely represented to or concealed from it were, or were based upon, subjective symptoms. Appellee tries to ignore this

by the following sweeping comment at page 30 of its brief:

“Moreover, the insured’s declarations were admissible to prove his knowledge of material facts concerning his health, *which facts were fully established by other evidence.*” (Emphasis added.)

Prompted by the italicized portion of the last above quoted excerpt from appellee’s brief, appellant asks appellee the oratorical question: What facts *material to the issues in this case* “were fully established” by evidence other than statements of Abe Lutz to said attending physicians, including statements by Abe Lutz as to his subjective symptoms?

Truth is implicit in the last above quoted statement from appellee’s brief, to wit: It is true that it is not enough to prove “knowledge” without establishing the fact with respect to which proof of “knowledge” is pertinent. This is apropos of appellee’s reference to the testimony of the witness Ludden which was admitted over appellant’s objection only for the purpose of showing knowledge. Knowledge itself without substantial showing of other facts is not sufficient to support the finding of false representation or concealment. The trial court expressly limited the testimony of the witness Ludden to the establishment of knowledge of Abe Lutz., *i. e.*, knowledge of pain. Evidence admitted merely for the purpose of showing *knowledge* cannot be later extended to supply the lacking element of competent evidence to establish the *facts* of which only knowledge has been proved.

VII.

The Defenses of Waiver and Estoppel Compel  
Reversal of the Trial Court's Judgment.

Appellee does not answer and makes no serious attempt to answer appellant's discussion of the evidence and authorities with respect to the defenses of waiver and estoppel. The cases cited by appellee with respect to waiver and estoppel at pages 20 to 25 both inclusive of its brief are merely inapplicable to the facts in this case. The *Twining v. Thompson* (68 Cal. App. (2d) 104), case which we have previously discussed, does not even have anything to do with the law of insurance and is totally inapplicable. The insurance cases cited by appellee involve, in each instance, facts which are totally different from those in the case at bar.

The substance of appellee's effort to answer appears to be that unless appellee had *knowledge* of the validity of the representations, the defenses of waiver and estoppel are inapplicable. This assertion ignores the special uncontroverted facts as shown by the undisputed evidence in this case and the law applicable thereto. Appellee has made no criticism of appellant's statement of the facts bearing on this phase of the matter. Clearly, appellee, under the sections of the California Insurance Code hereinabove cited, is chargeable with knowledge of the facts which it had "the means of ascertaining." Clearly too, the other party to the insurance contract is not bound to communicate information of matters which the insurer, in the exercise of ordinary care, ought to know, and the insurer's failure under such circumstances to ascertain such information constitutes its waiver of its right to such information. Knowledge which is sufficient to lead a prudent

person to inquire about the matter, when it could have been conveniently done, constitutes notice of whatever the inquiry would have disclosed.

*Columbian Nat'l. Life Ins. Co. v. Rodgers*, citing *Supreme Lodge, K. P. v. Kalinski*, 163 U. S. 289; 41 L. Ed. 163.

Furthermore, appellee, by failing to differentiate the instant case from the *Turner* case, has by implication confessed the application of the doctrine of waiver and estoppel therein applied to the paralleling facts involved in this case. In the *Turner* case, as in this case, the insurer made no investigation when it was furnished with the names of the attending physicians of the insured and issued its policy and accepted the premiums, thus lulling the policyholder into believing that the policy of insurance was a valid and subsisting contract between the parties. Under those facts, the court in the *Turner* case (13 Cal. App. (2d) 573), did not hesitate to and did apply the doctrine of both waiver and estoppel.

The ease with which appellee could have investigated and ascertained the information with respect to the facts which it claims were concealed from and misrepresented to it, is demonstrated by the self-evident fact that appellee's agent, Harold Morgan, did contact the office of Dr. Rosenfeld before delivery of the policy to appellant, but for reasons satisfactory to Mr. Morgan, he did not personally talk to Dr. Rosenfeld [I, 147]. Dr. Rosenfeld testified that no one on behalf of the appellee ever contacted him until after the insured's death [I, 148]. Dr. Rosenfeld further testified that all of the information concerning which he testified in open court was available to

appellee prior to the death of Abe Lutz. Certainly if inquiry had been made of Dr. Rosenfeld before issuance of the policy, all of the information which the appellee now claims was concealed from or misrepresented to it by Abe Lutz could have been conveniently and easily ascertained.

Additionally, estoppel is predicated upon appellant's change of position in reliance upon the validity of the policy in suit. In reliance thereon appellant cancelled, to his financial prejudice, other policies on the life of Abe Lutz, his father [I, 187-188]. Further, appellee, without complaint or investigation, accepted from appellant two annual premiums.

The language in the *Turner* case is so pointed as applied to the conduct of appellee in the instant case, particularly as applied to the defenses of estoppel and waiver, that we quote from page 578, as follows:

“Defendant had placed at its disposal the exact source from which it could obtain the information which it now maintains was withheld from it. It did not choose to make any inquiry but issued its policy with extreme promptness to say the least, and accepted deceased's money for six years, during all of which time defendant led her to believe she had a valid and enforceable policy of insurance on her life. Under such circumstances defendant should not be permitted to come into court after death had sealed the insured's lips and prevented her from explaining, if she could, why she did not mention an operation in 1926 when she did mention an illness and treatment by physicians which, we conclude from

the evidence and proffer of proof, occurred at the same time as the operation. The illness and some treatment though not the correct organ involved, were disclosed, and only the fact of an operation to effect a cure was withheld.”

That there was a *duty* to *investigate* in this case, as in the *Turner* case, in view of the knowledge possessed by appellee, is stated by the court in the following language:

“As defendant made no investigation when it should and could have, and as it issued its policy of insurance, accepted Mrs. Turner’s money for six years and lulled her into the secure belief that she had a valid policy of life insurance, it must be held that it *waived* the misstatement in the application and is now *estopped* from asserting the purported fraud.”  
(Emphasis added.)

The case of *Gates v. General Casualty Co. of America* (120 F. (2d) 925), cited by appellee at page 20 of its brief, does not involve the special facts presented in the instant case by which knowledge of the insured’s health and other factors were brought to the knowledge of the insurer which was thus put on notice. Neither *Telford v. N. Y. Life Ins. Co.*, 9 Cal. (2d) 103, *Frederick v. Federal Life Ins. Co.*, 13 Cal. App. (2d) 585, nor *Maggini v. West Coast Life Ins. Co.*, 136 Cal. App. 472, involve facts similar to those in the instant case. It is significant too that appellee has failed to comment upon sections 332, 333, 335 and 336 of the *California Insurance Code* pertaining to the waiver of its right to information of material facts (which it claims were misrepresented to and concealed from it) by its neglect to make inquiries as to such facts

where they were distinctly implied in other facts of which information was communicated.

Even assuming (without conceding, because the law clearly is to the contrary) that appellee was under no duty to make any investigation, nevertheless, it affirmatively appears that appellee did not rely upon the adequacy or accuracy of the answers of Abe Lutz in said Part II, and on the contrary sought, through its Los Angeles "general agents" [I, 271], to obtain information concerning:

1. Why Dr. Lissner (a doctor whose name was not mentioned by Abe Lutz in Part II) was consulted?
2. Why Dr. Rosenfeld was consulted?
3. What were the symptoms?
4. What were the findings?
5. What treatment or advice was given?
6. What were the results [II, 432].

In other words, appellee, by its own interpretation of the answers of Abe Lutz in Part II, felt that they were inadequate, or in any event appellee was concerned to the point that it desired and requested "full details" in this regard [II, 432] which obviously appellee must therefore have felt that it did not have. This request of appellee was made to its "general agents" in Los Angeles simultaneously and concurrently with its letter [II, 432] in explanation of its telegram [II, 427] to its general agents in Los Angeles dated December 1, 1942, advising that the issuance of the policy in suit was approved but that appellee was unable to consider two requested additional policies on the life of Abe Lutz without a more complete answer to the questions in Part II.



Having initiated an investigation and thus been "on inquiry," appellee is chargeable with knowledge of whatever such an investigation would have revealed and it cannot defend itself merely by saying that its Los Angeles general agents carelessly and negligently failed to make the requested investigation. The policy was thereafter delivered to appellant (not delivered to Abe Lutz) and appellant paid and appellee received and retained two annual premiums thereafter. The evidence upon the trial of the instant case was so strong in favor of the negligent and abortive investigation made by appellee that the following appears in Paragraph XXIII of the findings of fact:

"It is true that plaintiff's representatives *contacted* the office of the *physician* of said *insured*, but it is not true that they obtained, or that plaintiff had the opportunity of obtaining, full, true or correct information from such physician regarding the physical condition and health of said insured." (Emphasis ours.)

The latter portion of the above quoted finding can be no stronger than the uncontraverted evidence which was to the effect that appellee had not contacted Dr. Rosenfeld [I, 146-148] but that Dr. Rosenfeld, had he been contacted by appellee, would have made available to appellee all of the evidence and information (disclosed at the time of the trial), which appellee now claims to have been withheld from and misrepresented to it.

**Conclusion.**

We respectfully submit that appellant has demonstrated that the trial court erred in the respects herein and in the opening brief enumerated, and that the judgment should be reversed.

Respectfully submitted,

McLAUGHLIN, MCGINLEY & HANSON,

WILLIAM L. BAUGH,

*Attorneys for Appellant.*

No. 11185

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United States  
Circuit Court of Appeals  
For the Ninth Circuit.

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WILLIAM COXON,

Appellant,

vs.

SOUTHERN PACIFIC COMPANY, a corporation,  
tion,

Appellee.

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Transcript of Record

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Upon Appeal from the District Court of the United States  
for the District of Arizona

FILED

APR 17 1945

PAUL P. O'BRIEN,  
CLERK



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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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In the Superior Court of the State of Arizona in  
and for the County of Maricopa

Civ—662-Phx.

No. 54057—Div. 2

WILLIAM COXON,

Plaintiff,

vs.

SOUTHERN PACIFIC COMPANY, a corpora-  
tion,

Defendant.

### COMPLAINT

Comes Now William Coxon, plaintiff above named, by his attorneys undersigned, and complaining of Southern Pacific Company, a corporation, defendant above named, alleges:

#### I.

That William Coxon, plaintiff herein, is a resident of Casa Grande, County of Pinal, State of Arizona; that the defendant, Southern Pacific Company, is a corporation organized and existing under and by virtue of the laws of the State of Kentucky and authorized to do business, and is doing business, as a common carrier by railroad in the State of Arizona, and particularly in the counties of Maricopa, Pinal and Pima, and other counties in the State of Arizona through which it operates its railroad business.

## II.

That heretofore, on or about the 5th day of June, 1917, plaintiff entered the employ of defendant as yard clerk on what is known as the Tucson Division of defendant, Southern Pacific Company, and ever since said date, and up to the 28th day of September, 1944, continued in said employment in various clerical positions on said Tucson Division.

## III.

That during the early part of the year 1944, plaintiff was importuned by various citizens and electors of the State of Arizona to announce his candidacy for the democratic nomination (and election) to the office of Governor of the State of Arizona; that on or about the 9th day of February, 1944, plaintiff became ill and, due to said illness, obtained leave of absence from his duties with defendant, and remained absent from said duties because of said illness until the 29th day of March, 1944, at which time plaintiff, in order to conduct his campaign for said office, made application to defendant for leave of absence until the 31st day of July, 1944, and defendant, through its officers and agents, granted plaintiff a ninety day leave of absence beginning the 9th day of February, 1944, and ending the 9th day of May, 1944; that on or about the 26th day of April, 1944, plaintiff requested an extension of his leave of absence for ninety days in order to conduct and continue his campaign for said democratic nomination for Governor of the State of Arizona; that thereafter, and

on the 13th day of May, 1944, defendant instructed plaintiff that by reason of a rule, regulation, or order adopted by defendant, by mutual agreement theretofore entered into between defendant and a labor organization or association known as the Brotherhood of Railway and Steamship Clerks, Freight Handlers, Express and Station Employees, of which labor organization plaintiff was not and is not now a member, plaintiff's request for further leave of absence was denied and plaintiff was instructed to report for duty immediately; that said refusal to grant said extension of leave of absence was attributed to by defendant to refusal of said labor organization or association to agree to an extension of plaintiff's leave of absence beyond the 9th day of May, 1944, as provided in said agreement entered into between the defendant and said labor organization or association, as [5] aforesaid; that thereafter, pursuant to said rule, regulation or order, and agreement aforesaid, and on or about the 25th day of May, 1944, plaintiff's employment with defendant as general clerk at Casa Grande, County of Pinal, State of Arizona, was declared permanently vacant, and on the 28th day of September, 1944, defendant advised plaintiff in writing that his services with defendant were terminated.

#### IV.

That defendant, its officers and agents, in enforcing and attempting to enforce said order, rule, regulation and agreement, and by the use of said device or method, attempted to prevent plaintiff

from engaging in political activities and in accepting candidacy for nomination for the office of Governor of the State of Arizona, and thereby attempted to deprive plaintiff of the civil rights guaranteed to plaintiff by the Constitution and laws of the State of Arizona.

#### V.

That said written agreement entered into by defendant, Southern Pacific Company, and said labor organization or association, effective October 1st, 1940, provides by Rule 39 thereof, as follows:

#### “LEAVE OF ABSENCE

##### Rule 39.

(a) Employees may be granted leave of absence, limited except in case of illness or other physical disability, to ninety (90) calendar days in any calendar year without loss of seniority. Retention of seniority during longer leave of absence may be arranged for by agreement between employing officer and local committee. Leave of absence in excess of thirty (30) calendar days must be in writing. An employee returning from leave of absence shall give at least eight (8) hours' advance notice to his immediate superior of his intention to assume duty on his position.

(b) Members of General or Local Committees, representing employees covered by these rules, will be granted leave of absence without unnecessary delay, and without loss of seniority.” [6]

## VI.

That plaintiff was at no time a party to said agreement entered into by defendant and said labor organization, and said agreement did not, and could not, have any binding effect upon plaintiff as an employee of defendant, Southern Pacific Company.

## VII.

That it was and is provided by Rule 810 of the General Rules and Regulations of the defendant, Southern Pacific Company, as follows:

“Employees must not engage in any other business without permission from proper officer. They must report for duty at the prescribed time and place and devote themselves exclusively to their duties during prescribed hours.”

## VIII.

That it was and is provided by Chapter 10, Sections 1 and 2, of the Laws of the Legislature of the State of Arizona enacted in 1923, as consolidated and revised in Section 43-1508, Arizona Code Annotated 1939, as follows:

“43.1508. Corporation Restraining or Aiding Political Activities of Employee—Penalty.—It shall be unlawful for any corporation, its officers or agents, to make, enforce, or attempt to enforce, any order, rule or regulation, or adopt any other device or method to prevent an employee from engaging in political activities, accepting candidacy for nomination or election to, or the holding of political office, or from holding a position as a mem-

ber of any political committee; or from soliciting or receiving funds for political purposes; or from acting as chairman or participating in a political convention; or assuming the conduct of any political campaign; or for any corporation, its officers or agents to instigate, encourage, aid or assist, whether by personal service or contributing money or anything of value, any employee in its employ to run for or be elected to any political office; or for any corporation, its officers or agents to pay or contribute anything of value, whether in wages, fees or contributions, to any such employee in its employ while such employee is engaged in the official duties of the office to which such employee is elected; or from casting his ballot or vote as his conscience may command. Any employer may suspend the wages or compensation of an employee elected to office when his duties as such officer interfere with his duties as employee. Any person violating any provision of this section shall be guilty of a misdemeanor, and punished, if a corporation, by a fine of not less than five hundred dollars (\$500), nor more than five thousand dollars (\$5,000); and if a natural person by a fine of [7] not less than five hundred dollars (\$500) nor more than five thousand dollars (\$5,000), or by imprisonment in the county jail not less than six (6) months nor more than two (2) years, or by both such fine and imprisonment."

## IX.

That in violation of said law of the State of Arizona, as set forth in the preceding paragraph of

this complaint, and in violation of the rights guaranteed by said law to plaintiff, defendant on September 28th, 1944, unlawfully and wrongfully discharged plaintiff from his employment with defendant, as aforesaid, all to plaintiff's great harm and damage, and has caused plaintiff to suffer great humiliation and embarrassment. That at the time of such discharge, plaintiff was earning a monthly salary of approximately \$180.00, which was paid to plaintiff by defendant.

### X.

That from the date of the first employment of plaintiff by defendant on June 5th, 1917, until plaintiff's discharge by defendant on September 28th, 1944, plaintiff had accumulated valuable seniority rights as an employee of defendant, which were totally destroyed and lost by plaintiff's unlawful and wrongful discharge by defendant, as aforesaid, all to plaintiff's great harm and damage.

### XI.

That said seniority rights entitled and enabled plaintiff to own, control and exercise valuable rights of employment with defendant superior to the seniority rights of employment of other employees of defendant who held seniority rights in the same capacity as plaintiff but for a lesser period of time than plaintiff; and such seniority rights entitled plaintiff to seek and acquire from defendant preferences as to the character of services to be performed by him, the location of his employment, the amount of the salary he was en-



titled to earn, as well as the prestige arising from such seniority rights.

## XII.

That at the time defendant discharged plaintiff on [8] September 28th, 1944, as aforesaid, plaintiff had then been employed by defendant for approximately twenty-seven (27) years, and at the time of such discharge plaintiff had then reached the age of 48 years; that notwithstanding plaintiff's age, he would have been permitted, except for the wrongful and unlawful discharge of plaintiff, as aforesaid, to continue in the employ of defendant in the capacity plaintiff was employed at the time of his discharge, and by reason of plaintiff's discharge, as aforesaid, he is now disqualified and prohibited from seeking similar employment with other railroad companies or corporations; and plaintiff is unable to secure a similar employment for comparable compensation and with the same rights and advantages heretofore enjoyed by him.

## XIII.

That plaintiff is informed and believes, and upon such information and belief alleges, that defendant, Southern Pacific Company, and said labor organization, through their duly constituted officers and agents, devised and conspired with each other to deprive plaintiff of the opportunity and right to seek the nomination as the democratic candidate for Governor of the State of Arizona, and to seek election to said office, and plaintiff is further in-

formed and believes, and upon such information and belief, alleges, that such device and conspiracy resulted from the fact that both defendant, Southern Pacific Company, and said union, did not desire the nomination and election of plaintiff as Governor of the State of Arizona, but preferred the election of some person other than plaintiff to such office.

#### XIV.

That as a result of the unlawful and wrongful conduct of the defendant in discharging plaintiff, as alleged aforesaid, plaintiff, in addition to the damages suffered by him, as aforesaid, has also suffered damages in this: [9]

(a) That plaintiff as an employee of defendant, and until wrongfully discharged by defendant, as aforesaid, was entitled to the benefits of the Railroad Retirement Act of 1935, and the amendments and supplements thereto, as enacted by the Congress of the United States (Title 45, Secs. 215 to 228 inclusive, U.S.C.A.) and plaintiff, by said wrongful discharge, has lost and has been deprived of the benefits accorded him by said Railroad Retirement Act.

(b) Plaintiff as an employee of defendant, as aforesaid, was authorized to purchase, and plaintiff did purchase, from defendant, group life insurance payable upon the death of plaintiff in the amount of \$2,000.00, the cost of which was deducted from plaintiff's monthly salary, and under said policy of insurance, plaintiff's family, consisting of a wife and eight (8) children, as beneficiaries of

said insurance, would be entitled to the principal sum thereof upon the death of plaintiff. That subsequent to the discharge of plaintiff by defendant, as aforesaid, plaintiff tendered to defendant the premium upon such policy of insurance which defendant refused to accept, thereby causing said insurance to lapse.

(c) That during the time plaintiff was employed by defendant, as aforesaid, plaintiff and the several dependent members of his family, were entitled to transportation without cost over the railroad lines of defendant, and over other railroad lines operating in the United States, the Dominion of Canada and the Republic of Mexico. That the reasonable value of said transportation to plaintiff and his family was \$300.00 per year; that the benefits of such transportation would continue to plaintiff and the dependent members of his family after the retirement of the plaintiff from his employment with defendant; that the benefits of said transportation have been lost to plaintiff and denied to him by defendant as a result of such wrongful discharge; that defendant demanded of plaintiff, after plaintiff's discharge, [10] that he return the pass evidencing the right to such transportation, and said pass was returned by plaintiff to defendant.

(d) That during the time plaintiff was employed by defendant, as aforesaid, plaintiff was entitled to receive from defendant, through facilities afforded by defendant, medical and hospital treatment, which were and are of the reasonable value

of \$150.00 per annum; that during time of plaintiff's employment by defendant as aforesaid, defendant deducted each month from plaintiff's salary, the sum of \$1.75 as payment for said medical and hospital benefits; that as a result of plaintiff's wrongful discharge by defendant as aforesaid, plaintiff has now lost and is denied such medical and hospital benefits.

### XV.

That by reason of the unlawful, wrongful and tortious conduct of defendant in discharging plaintiff from the employ of defendant, as aforesaid, plaintiff has been damaged in the sum of fifty thousand (\$50,000.00) dollars actual or general damages, and in the additional sum of fifty thousand (\$50,000.) dollars as and for exemplary or punitive damages.

Wherefore, plaintiff prays judgment against defendant for the sum of one hundred thousand (\$100,000.00) dollars, and his costs herein expended.

LOUIS B. WHITNEY,

LESLIE C. HARDY,

Attorneys for Plaintiff.

[Endorsed]: No. 54057. Filed Jan. 26, 1945.

[Title of Superior Court and Cause.]

SUMMONS

The State of Arizona to the above named defendant Southern Pacific Company, a corporation,

You Are Hereby Summoned and required to appear and defend in the above entitled action in the above entitled court, within Twenty Days, exclusive of the day of service, after service of this summons upon you if served within the State of Arizona, or within Thirty Days, exclusive of the day of service, if served without the State of Arizona, and you are hereby notified that in case you fail so to do, judgment by default will be rendered against you for the relief demanded in the complaint.

The names and addresses of plaintiff's attorneys are Louis B. Whitney and Leslie C. Hardy, Suite 1006, Luhrs Tower, Phoenix, Arizona.

Given under my hand and the seal of the Superior Court of the State of Arizona in and for the County of Maricopa, this 26th day of January, 1945.

[Court Seal] WALTER S. WILSON,  
Clerk.

By G. F. ELLSWORTH,  
Deputy Clerk. [12]

State of Arizona,

County of Maricopa—ss.

I Hereby Certify that I received the within Summons on the 26th day of January, A. D. 1945, at

the hour of 10:35 A. M., and personally served the same on the 26th day of January, A. D. 1945, Southern Pacific Company, a corporation, being the said defendant named in said Summons, by delivering to D. B. Morgan, in person, as Statutory Agent for Southern Pacific Co., County of Maricopa, a copy of said Summons, to which was attached a true copy of the complaint mentioned in said Summons.

Dated this 26th day of January, A. D. 1945.

Fees, Service .....	\$1.50
Travel 1 mile.....	.30

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Total .....	\$1.80
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ERNEST W. ROACH,  
Sheriff.

By CALVIN R. SANDERS,  
Deputy Sheriff.

[Endorsed]: Filed Jan. 27, 1945.

[Endorsed]: Filed. E. W. Roach, Sheriff, Maricopa County, 10:34 A. M., Arizona, Jan. 26, 1945.

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[Title of Superior Court and Cause.]

#### NOTICE OF APPLICATION FOR REMOVAL

To William Coxon, plaintiff, and to Messrs. Louis B. Whitney and Leslie C. Hardy, his attorneys:

Please take notice that defendant will, on the 15th day of February, 1945, at or about 9:15 o'clock A. M., file in the above designated court, and in the

office of the clerk thereof, its petition and bond for the removal of the above entitled and numbered suit to the District Court of the United States, for the District of Arizona, and will, immediately thereafter, or as soon as counsel can be heard, call up said petition and bond for hearing and disposition before the said court, in Division No. 2.

Copies of said petition and bond are served upon you herewith.

Dated this 13th day of February, 1945.

ELLINWOOD & ROSS.

NORMAN S. HULL,

Attorneys for Defendant.

Copy received this 13th day of February, 1945.

LOUIS W. WHITNEY,

LESLIE C. HARDY,

Attorneys for Plaintiff.

[Endorsed]: Filed Feb. 15, 1945. [13]

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[Title of Superior Court and Cause.]

PETITION FOR REMOVAL OF SUIT TO THE  
DISTRICT COURT OF THE UNITED  
STATES, FOR THE DISTRICT OF ARIZONA

To the Honorable The Superior Court of the  
State of Arizona, in and for the County of Maricopa:

The petition of defendant Southern Pacific Company, hereinafter called "petitioner," respectfully shows:

I.

This is a suit of civil nature at law, brought by William Coxon, as plaintiff, against petitioner, as sole defendant, to recover damages in the amount of \$100,000.00, for the alleged wrongful discharge of plaintiff by petitioner from petitioner's employ.

II.

The amount in controversy, at the time of commencement of this suit exceeded, and now exceeds, the sum of \$3,000.00, exclusive of interest and costs.

III.

Plaintiff was, at the time of commencement of this action, and now is, a citizen and resident of the State of Arizona, and [14] petitioner was, at the time of commencement of this action, and now is, a corporation duly organized and existing under and by virtue of the laws of the State of Kentucky, and a citizen and resident of the State of Kentucky.

IV.

The time within which petitioner is required to move, answer, plead or otherwise appear herein has not expired, and petitioner has not moved, answered, pleaded or otherwise appeared herein.

V.

By reason of the matters and things aforesaid, this is a suit of which the district courts of the



United States are given original jurisdiction, and is removable to the District Court of the United States, for the District of Arizona.

## VI.

Petitioner appears herein specially and solely to remove this suit to the District Court aforesaid on the grounds herein asserted, and petitioner presents herewith a bond, with good and sufficient surety, that petitioner will enter in said District Court within thirty days from the date of filing this petition, a certified copy of the record in this suit and for the payment of all costs which may be awarded by said District Court if said District Court shall hold that this suit was wrongfully or improperly removed thereto.

Wherefore, petitioner prays that this Honorable Court proceed no further herein, except to make an order of removal and to accept said bond, and to cause the record herein to be removed into the District Court of the United States, for the [15] District of Arizona.

Dated this 13th day of February, 1945.

ELLINWOOD & ROSS.

NORMAN S. HULL,

Attorneys for Petitioner.

State of Arizona,

County of Maricopa—ss.

Norman S. Hull, being duly sworn, deposes and says that he is one of the attorneys for Southern

Pacific Company, the petitioner in the foregoing petition, that he makes this affidavit for and in behalf of said petitioner, and that he has read said petition, and that the allegations thereof are true.

NORMAN S. HULL.

Subscribed and sworn to before me this 13th day of February, 1945.

[Seal] GRAYCE R. HILER,  
Notary Public.

My Commission expires: 2-20-46.

Copy received this 13th day of February, 1945.

LOUIS B. WHITNEY,  
LESLIE C. HARDY,  
W.

Attorneys for Plaintiff.

[Endorsed]: Filed Feb. 15, 1945. [16]

---

[Title of Superior Court and Cause.]

### REMOVAL BOND

Know All Men By These Presents: That Saint Paul-Mercury Indemnity Company, a corporation, duly authorized to engage in a general indemnity and surety business within the State of Arizona, is held and firmly bound unto William Coxon, plaintiff in the above designated and numbered cause, his successors and assigns, in the penal sum of Five Hundred Dollars (\$500), lawful money of the United States of America, for the payment of which well and truly to be made, it binds itself,

its representatives, successors and assigns, by these presents.

The condition of this obligation is that

Whereas, Southern Pacific Company, a corporation, one of the defendants above named, is about to petition the Superior Court of the State of Arizona, in and for the County of Maricopa, for the removal of the above entitled and numbered cause, therein pending, from said Court to the District Court of the United States, for the District of Arizona.

Now, Therefore, if the said Southern Pacific Company, a corporation, defendant, shall enter in the said District Court of the United States, for the District of Arizona, within thirty [17] (30) days from the date of filing its petition for removal, a certified copy of the record in said suit, and shall pay all costs that may be awarded by the said District Court of the United States, for the District of Arizona, if it shall hold that said suit was wrongfully or improperly removed thereto, then this obligation shall be void; otherwise it shall remain in full force and effect.

In Witness Whereof, Saint Paul-Mercury Indemnity Company has caused this removal bond to be executed by its duly authorized attorney-in-fact at Phoenix, Arizona, this 12th day of February, 1945.

[Seal]

SAINT PAUL-MERCURY IN-  
DEMNITY COMPANY.

By G. H. MYERS,  
Attorney-in-Fact.

State of Arizona:

County of Maricopa—ss.

This instrument was acknowledged before me this 12th day of February, 1945, by G. H. Myers, as attorney-in-fact for Saint Paul-Mercury Indemnity Company, a corporation, who personally appeared before me and stated that he executed the same as such attorney-in-fact, being thereunto duly authorized.

My commission expires February 20, 1946.

[Seal]                      GRAYCE R. HILER,  
Notary Public.

The Above Bond was duly approved by me this  
..... day of February, 1945.

.....  
Judge.

Copy received this 13th day of February, 1945.  
LOUIS W. WHITNEY,  
LESLIE C. HARDY,  
W.

Attorneys for Plaintiff.

[Endorsed]: Filed Feb. 15, 1945. [18]

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[Title of Superior Court and Cause.]

Court convened at 9:30 A. M., Thursday, February 15, 1945. Present: Dudley W. Windes, Judge; Walter S. Wilson, Clerk; the Sheriff; the County Attorney; and the Court Reporter.

Comes now Norman S. Hull, appearing as Counsel on behalf of the Defendant, thereupon

It Is Ordered, on motion of Counsel for the defendant, removing the above-entitled cause to the United States District Court for the District of Arizona. [19]

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[Title of Superior Court and Cause.]

ORDER FOR REMOVAL OF SUIT TO THE  
DISTRICT COURT OF THE UNITED  
STATES, FOR THE DISTRICT OF ARIZONA

This cause came on regularly to be heard on the petition of defendant, Southern Pacific Company, for an order of removal, accompanied by proper bond, and it appearing that this is a proper case for removal, it is

Ordered, Adjudged and Decreed that:

(1) The removal bond be, and the same is hereby approved and accepted;

(2) This cause be, and the same is hereby removed to the District Court of the United States, for the District of Arizona.

(3) The clerk be, and he is hereby directed to prepare the record in this cause for removal;

(4) All other proceedings of this Court be, and the same hereby stayed.

Dated This 15th day of February, 1945.

DUDLEY W. WINDES,  
Judge.

[Endorsed]: Filed Feb. 15, 1945. [20]

[Title of Superior Court and Cause.]

State of Arizona,

County of Maricopa—ss.

I, Walter S. Wilson, Clerk of the Superior Court of Maricopa County, State of Arizona, hereby certify the above and foregoing to be a full, true, and correct copy of the record, and the whole thereof, in the above entitled suit heretofore pending in the Superior Court of Maricopa County, Arizona, being suit Number 54057, wherein William Coxon was Plaintiff, and Southern Pacific Company was Defendant, said record consisting of: Complaint, filed January 26, 1945; Summons, issued January 26, 1945, and filed January 27, 1945; Notice of Application for Removal, filed February 15, 1945; Petition for Removal of Suit to the District Court of the United States, for the District of Arizona, filed February 15, 1945; Removal Bond, filed February 15, 1945; Minute Order of February 15, 1945; and Order for Removal of Suit to the District Court of the United States for the District of Arizona, filed February 15, 1945, all as appear in the files and of record in my office.

Attest my hand and the Seal of said Court at Phoenix, Arizona, this 13th day of March, 1945.

[Seal]

WALTER S. WILSON,

Clerk of the Superior Court.

By ERNEST R. MORRIS,

Deputy.

[Endorsed]: Filed Mar. 16, 1945. [21]

In the District Court of the United States,  
for the District of Arizona

No. Civ. 662—Phx.

WILLIAM COXON,

Plaintiff,

vs.

SOUTHERN PACIFIC COMPANY, a corpora-  
tion,

Defendant.

### MOTION TO DISMISS ACTION

Defendant moves the court to dismiss the action because the complaint fails to state a claim against defendant upon which relief can be granted, in that:

(1) It shows upon its face that plaintiff was discharged for good cause, for his failure and refusal to return to, and perform his duties and render service to defendant, and for his failure and refusal to comply with reasonable rules governing his employment.

(2) It shows upon its face that plaintiff was discharged for good cause, for his failure and refusal to comply with the collective labor agreement between defendant and the Brotherhood of Railway and Steamship Clerks, Freight Handlers, Express and Station Employees, and with the rules and regulations promulgated and in effect thereunder.

(3) It shows upon its face that plaintiff was

discharged for good cause under the collective labor agreement and the rules and regulations promulgated and in effect thereunder. [22]

(4) It does not allege that plaintiff was employed for a definite period of time extending beyond the date of his discharge, nor that the employment contract was not terminable at the will of defendant.

(5) It does not allege, either in haec verba, or in substance, the employment contract, or the terms of employment.

(6) It purports to state a claim in tort for wrongful discharge from employment, whereas defendant is not answerable in tort on the allegations made.

(7) It purports to state a claim under the terms and provisions of Section 43-1508, Arizona Code Annotated, 1939, whereas, as appears from the allegations, said statute is inapplicable in the premises.

(8) If Section 43-1508, Arizona Code Annotated, 1939, should be construed as applicable in the premises, then insofar as it purports to support plaintiff's theory, or to authorize recovery against defendant, it is in conflict with Article II, Section 4, Constitution of Arizona, and with the Fourteenth Amendment to the Constitution of the United States, in that it deprives the defendant of its liberty and property without due process of law.

(9) If Section 43-1508, Arizona Code Annotated, 1939, should be construed as applicable in



the premises, then insofar as it purports to support plaintiff's theory, or to authorize recovery against defendant, it is in conflict with Article II, Section 13, and Article IV, Part 2, Section 19, subsections 7 and 13, in that it grants to citizens and classes of citizens, privileges and immunities which, upon the same terms do not equally belong to defendant thereunder [23] and in that it is a special law for the punishment of crimes and misdemeanors, and grants to associations and individuals special and exclusive privileges and immunities.

(10) If Section 43-1508, Arizona Code Annotated, 1939, should be construed as applicable in the premises, then insofar as it purports to support plaintiff's theory, or to authorize recovery against defendant, it is in conflict with the Fourteenth Amendment to the Constitution of the United States in that it denies to defendant the equal protection of the laws of the State of Arizona.

Respectfully submitted,

ELLINWOOD & ROSS.

NORMAN S. HULL,

Attorneys for Defendant.

Copy of the foregoing Motion to Dismiss Action received this 20th day of March, 1945.

LOUIS B. WHITNEY,

LESLIE C. HARDY,

Attorneys for Plaintiff.

[Endorsed]: Filed Mar. 20, 1945. [24]

[Title of Court and Cause.]

DOCKET ENTRIES—FILING—  
PROCEEDINGS

1945

- Mar. 16—1 File Defendant's Certified Copy of Record on Removal to the District Court of the United States for the District of Arizona  
(Complaint  
(Summons  
(Notice of Application for Removal  
(Petition for Removal of Suit to the District Court of the United States, for the District of Arizona  
(Removal Bond  
(Minute Entry of Thursday, February 15, 1945  
(Order for Removal of Suit to the District Court of the United States, for the District of Arizona  
(Certificate of Walter S. Wilson, Clerk of the Maricopa County Superior Court).
- Mar. 20—2 File defendant's Motion to Dismiss Action.
- Mar. 20—3 File defendant's Motion to Strike and Motion for More Definite Statement.
- Mar. 20—4 File Defendant's Brief in Support of its Motion to Dismiss, Motion to Strike, and Motion for More Definite Statement.
- July 25— It is ordered that defendant's Motion to Dismiss be and it is granted.

1945

- July 25— Issue Notice to Counsel.
- Sept. 10— Norman S. Hull, Esq., pres. for deft. No other appearance. Hull now presents form of Judgment. Order said form of judgment presented, approved, entered, filed and spread upon the minutes as judgment herein.
- Sept. 10—5 Enter and file Judgment dismissing case and awarding costs to defendant.
- Sept. 10—6 File defendant's Statement of Costs and Notice for taxation thereof.
- Sept. 11— Deft's costs taxed as claimed in sum of \$21.35 and entered in J. D.
- Oct. 9— Issue notice to counsel of entry of judgment on 9/10/45.
- Oct. 22—7 File Plaintiff's Notice of Appeal.
- Oct. 22— Forward cc Notice of Appeal to Ellinwood & Ross, counsel for deft.
- Oct. 22—8 File Plaintiff's Bond for Costs on Appeal with Fireman's Fund Indemnity Company in sum of \$250.00.
- Oct. 22—9 File Plaintiff's Designation of Contents of Record on Appeal Pursuant to Rule 75 (a) of the Federal Rules of Civil Procedure.
- Oct. 22—10 File Plaintiff's Statement of Points Relied on.
- Oct. 29—11 File deft's Designation of Additional Portions of the Record on Appeal, Pursuant to Rule 75 (a), Federal Rules of Civil Procedure. [25]

[Title of Court and Cause.]

Honorable Dave W. Ling, United States District  
Judge, Presiding.

April, 1945, Term at Phoenix

MINUTE ENTRY

Of Wednesday, July 25, 1945

(Phoenix Division)

It Is Ordered that defendant's Motion to Dis-  
miss be and it is granted.

[Title of Court and Cause.]

Honorable Dave W. Ling, United States District  
Judge, presiding.

April, 1945, Term at Phoenix

MINUTE ENTRY

Of Monday, September 10, 1945

(Phoenix Division)

Norman S. Hull, Esquire, is present for the de-  
fendant. No appearance is made by or on behalf of  
the plaintiff.

Norman S. Hull, Esquire, now presents form of  
judgment, and

It Is Ordered that said form of judgment be  
approved, entered, filed and spread upon the min-  
utes as the judgment herein as follows:

Civ.—662

WILLIAM COXON,

Plaintiff,

vs.

SOUTHERN PACIFIC COMPANY, a corporation,

Defendant.

### JUDGMENT

This cause having been duly submitted to the Court, the Honorable D. W. Ling presiding, on plaintiff's complaint and defendant's motion to dismiss this action, and the Court having sustained said motion, now, on the motion of Norman S. Hull, attorney for defendant,

It Is Ordered, Adjudged and Decreed that this action be dismissed with costs awarded to defendant in the amount of \$21.35.

Made and entered this 10th day of September, 1945.

Approved as to form.

LOUIS B. WHITNEY,

LESLIE C. HARDY,

Attorneys for Plaintiff. [26]

In the District Court of the United States  
for the District of Arizona

No. Civ-662—Phx.

WILLIAM COXON,

Plaintiff,

vs.

SOUTHERN PACIFIC COMPANY, a corpora-  
tion,

Defendant.

### JUDGMENT

This cause having been duly submitted to the Court, the Honorable D. W. Ling presiding, on plaintiff's complaint and defendant's motion to dismiss this action, and the Court having sustained said motion, now, on the motion of Norman S. Hull, attorney for defendant.

It Is Ordered, Adjudged and Decreed that this action be dismissed with costs awarded to defendant and in the amount of \$21.35.

Made and entered this 10th day of September, 1945.

Approved as to form.

LOUIS B. WHITNEY,

LESLIE C. HARDY,

Attorneys for Plaintiff.

[Endorsed]: Filed Sept. 10, 1945. [27]

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice Is Hereby Given that William Coxon, Plaintiff above named, hereby appeals to the United States Circuit Court of Appeals for the Ninth Circuit from the final judgment entered in this action on the 10th day of September, 1945, dismissing this action with costs awarded to defendant.

Dated at Phoenix, Arizona, this 22nd day of October, 1945.

LOUIS B. WHITNEY,

LESLIE C. HARDY,

Attorneys for Plaintiff-Appellant, William Coxon.

Service Copy of foregoing admitted this 22nd October, 1945.

ELLINWOOD & ROSS.

By NORMAN S. HULL,

D.V.

Attys. for Deft.-Appellee.

[Endorsed]: Filed Oct. 22, 1945. [28]

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[Title of District Court and Cause.]

BOND FOR COSTS ON APPEAL

Know All Men by These Presents:

That Fireman's Fund Indemnity Company, a California corporation, duly authorized and licensed to do and transact a surety and bonding business in the State of Arizona, is held and firmly

bound unto the above named Southern Pacific Company, a corporation, in the sum of Two Hundred Fifty Dollars (\$250.00), to be paid to the said Southern Pacific Company, a corporation, for the payment of which well and truly to be made it binds itself, its successors and assigns, firmly by these presents.

Whereas, on the 25th day of July, 1945, the above entitled Court ordered defendant Southern Pacific Company's motion to dismiss the above entitled action be granted; and plaintiff-appellant declining to amend his complaint, thereafter and on the 10th day of September, 1945, a judgment was ordered and entered by the Court in the above entitled proceeding dismissing the above entitled action with costs awarded to Southern Pacific Company; and

Whereas, the plaintiff-appellant, William Coxon, feeling aggrieved thereby, appeals to the United States Circuit Court of Appeals for the Ninth Circuit.

Now, Therefore, the condition of this obligation is such that if the aforesaid order and judgment is affirmed or modified by the United States Circuit Court of Appeals for the Ninth Circuit, [29] or if the appeal is dismissed, the appellant, William Coxon, will pay all costs which may be awarded against him on said appeal.



Dated at Phoenix, Maricopa County, Arizona,  
this 22nd day of October, 1945.

[Seal]                      FIREMAN'S FUND INDEM-  
                                NITY COMPANY,  
By RALPH A. CASH,  
                                Its Atty.-in-Fact.

[Endorsed]: Filed Oct. 22, 1945. [30]

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[Title of District Court and Cause.]

STATEMENT OF POINTS RELIED ON

Plaintiff-appellant, William Coxon, having filed his Notice of Appeal from the final judgment in favor of the defendant-appellee and adverse to the plaintiff-appellant, made and entered in the above entitled cause on the 10th day of September, 1945, herewith makes his Statement of Points on which he intends to rely on the appeal:

1. That the District Court erred in entering its order of July 25th, 1945, granting defendant's motion to dismiss plaintiff's complaint, for the reason that the complaint states a claim against the defendant upon which relief can be granted.
2. That the District Court erred in rendering judgment dismissing this action after plaintiff had declined to further plead, following the order of the District Court of July 25th, 1945, granting defendant's motion to dismiss the complaint, for the reason that the complaint states a claim against defendant upon which relief can be granted. [31]

3. The judgment of the District Court, entered September 10th, 1945, dismissing this action is contrary to law and is erroneous, for the reason that defendant's motion to dismiss the complaint is insufficient in law to constitute a defense to plaintiff's complaint and action, and for the further reason that the complaint states a claim against defendant upon which relief can be granted, in this:

(a) The complaint shows, among other things, that plaintiff was discharged because of rules and regulations of the defendant claimed to have been violated by the plaintiff, which rules and regulations are in conflict with and in violation of the statutes of the State of Arizona in such cases made and provided, in that defendant required plaintiff to secure permission from a labor organization of which he was not a member and with which he had no agreement, before plaintiff's leave of absence would be extended by defendant, in violation of plaintiff's rights of contract and property.

(b) Section 43-1508, Arizona Code Annotated 1939, is applicable in the premises and that section does not conflict with either the Constitution of the State of Arizona or the Fourteenth Amendment to the Constitution [32] of the United States. Section 14-1508, *supra*, does not deprive the defendant of property without due process of law, nor does it deny defendant the equal protection of law, nor does the section fall within the category of a local or special law relating to punishment of crimes and misdemeanors, or the granting to any corporation, association or individual any special

or exclusive privileges, immunities or franchises, prohibited by Article II, Section 13, and Article IV, Part 2, Section 19, subsections 7 and 13 of the Constitution of the State of Arizona.

Dated at Phoenix, Arizona, this 22nd day of October, 1945.

LOUIS B. WHITNEY,

LESLIE C. HARDY,

Attorneys for Plaintiff-Appellant.

Received a copy of the foregoing this 22nd day of October, 1945.

ELLINWOOD & ROSS.

By NORMAN S. HULL,

D.V.

Attorneys for Defendant-Appellee.

[Endorsed]: Filed Oct. 22, 1945. [33]

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[Title of District Court and Cause.]

DESIGNATION OF CONTENTS OF RECORD  
ON APPEAL PURSUANT TO RULE 75  
(A) OF THE FEDERAL RULES OF CIVIL  
PROCEDURE

To the Clerk of the Above Entitled Court:

William Coxon, the plaintiff and appellant herein, designates the following portions of the record and proceedings to be contained in the record on his appeal herein.

1. The following portions of certified copy of record on removal to United States District Court for the District of Arizona filed in that Court March 16th, 1945:

(a) Complaint filed in state court January 26th, 1945.

(b) Summons and return of service in state court.

(c) Notice of Application for Removal dated February 13th, 1945, and filed February 15th, 1945.

(d) Petition for Removal of Suit to the District Court of the United States for the District of Arizona, dated February 13th, 1945, and filed [34] February 15th, 1945.

(e) Removal Bond dated February 12th, 1945, and filed February 15th, 1945.

(f) Order for Removal of Suit to the District Court of the United States for the District of Arizona, dated and filed February 15th, 1945.

(g) Clerk's Minute Entry of Superior Court of Maricopa County, Arizona, entered February 15th, 1945.

(h) Certificate of Clerk of Superior Court of Maricopa County, Arizona, dated March 13th, 1945.

2. Motion to Dismiss Action filed March 20th, 1945.

3. Clerk's Civil Docket Entry of July 25th, 1945.

4. Clerk's Civil Docket Entry of September 10th, 1945.

5. Clerk's Civil Docket Entry of October 9th, 1945.

6. Minute Entry of July 25th, 1945, granting Defendant's Motion to Dismiss.

7. Minute Entry of September 10th, 1945, re Entry of Judgment.

7a. Judgment of September 10, 1945.

8. Notice of Appeal.

9. Bond for Costs on Appeal.

10. Statement of Points on which Plaintiff-Appellant Intends to Rely on His Appeal.

11. This Designation.

Dated at Phoenix within the District of Arizona, this 22nd day of October, 1945.

LOUIS B. WHITNEY,

LESLIE C. HARDY,

Attorneys for Plaintiff-Appellant.

Received a copy of the foregoing this 22nd day of October, 1945.

ELLINWOOD & ROSS.

By NORMAN S. HULL,

D.V.

Attorneys for Defendant-Appellee. [35]

[Endorsed]: Filed Oct. 22, 1945.

[Title of District Court and Cause.]

DESIGNATION OF ADDITIONAL PORTIONS  
OF THE RECORD ON APPEAL, PURSU-  
ANT TO RULE 75 (A), FEDERAL RULES  
OF CIVIL PROCEDURE

To the Clerk of the Above Entitled Court:

Southern Pacific Company, the Defendant-Appellee herein, designates the following additional portions of the record and proceedings to be included in the record on appeal:

(1) Each and all of the Clerk's Civil Docket Entries in this Court;

(2) Each and all of the Minute Entries of and in this Court;

(3) This Designation.

Dated at Phoenix, Arizona, this 29th day of October, 1945.

ELLINWOOD & ROSS.

NORMAN S. HULL,

Attorneys for Defendant-Appellee.

Copy received this 29th day of October, 1945.

LOUIS B. WHITNEY,

LESLIE C. HARDY,

W.

Attorneys for Plaintiff-Appellant.

[Endorsed]: Filed Oct. 29, 1945. [37]

CERTIFICATE TO TRANSCRIPT OF  
RECORD ON APPEAL

United States of America,

District of Arizona—ss.

I, Edward W. Scruggs, Clerk of the United States District Court for the District of Arizona, do hereby certify that I am the custodian of the records, papers and files of said Court, including the records, papers and files in case No. Civ-662 Phoenix, William Coxon, Plaintiff, vs. Southern Pacific Company, a corporation, Defendant, on the docket of said Court.

I further certify that the attached pages, numbered 1 to 37, inclusive, contain a full, true and correct transcript of the proceedings of said cause and all the papers filed therein, together with the endorsements of filing thereon, called for and designated in the Designation of Contents of Record on Appeal and Designation of Additional Portions of Record on Appeal, filed in said cause and made a part of the transcript attached hereto, as the same appear from the originals of record and on file in my office as such Clerk, in the City of Phoenix, State and District aforesaid.

I further certify that the Clerk's fee for preparing and certifying to this said transcript of record amounts to the sum of \$5.50, and that said sum has been paid by counsel for the appellant.

Witness my hand and the seal of said Court at  
Phoenix, Arizona, this 13th day of November, 1945.

[Seal]                      EDWARD W. SCRUGGS,  
Clerk.

By WM. H. LOVELESS,  
Chief Deputy Clerk. [38]

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[Endorsed]: No. 11185. United States Circuit  
Court of Appeals for the Ninth Circuit. William  
Coxon, Appellant, vs. Southern Pacific Company,  
a corporation, Appellee. Transcript of Record.  
Upon Appeal from the District Court of the United  
States for the District of Arizona.

Filed November 16, 1945.

PAUL P. O'BRIEN,  
Clerk of the United States Circuit Court of Ap-  
peals for the Ninth Circuit.



In the United States Circuit Court of Appeals  
for the Ninth Circuit

No. 11185

WILLIAM COXON,

Appellant,

vs.

SOUTHERN PACIFIC COMPANY, a corpora-  
tion,

Appellee.

STATEMENT OF POINTS AND DESIGNA-  
TION OF RECORD FOR PRINTING (Sub-  
division 6 of Rule 19.)

Comes now the Appellant in the above entitled cause, and hereby adopts as his statement of points on which he intends to rely on this appeal the "Statement of Points Relied On," filed in the United States District Court for the District of Arizona, as it now appears on pages 31, 32, and 33 in the Transcript of the Record herein as transmitted to the above entitled court by the clerk of the United States District Court for the District of Arizona.

Appellant hereby designates for printing the entire certified Transcript of the Record as transmitted to this court by the clerk of the United States District Court for the District of Arizona.

Dated at Phoenix, within the District of Arizona, this 14th day of November, 1945.

LOUIS B. WHITNEY,

LESLIE C. HARDY,

Attorneys for Appellant.

Service of the foregoing Statement of Points and Designation of Record is acknowledged this 14th day of November, 1945.

ELLINWOOD & ROSS.

By WM. SPUID,

Attorneys for Appellee.

[Endorsed]: Filed November 16, 1945. Paul P. O'Brien, Clerk.

No. 11,185

United States  
Circuit Court of Appeals  
For the Ninth Circuit

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WILLIAM COXON,

*Appellant,*

vs.

SOUTHERN PACIFIC COMPANY,  
a corporation,

*Appellee.*

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BRIEF OF APPELLANT

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LOUIS B. WHITNEY,

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United States  
Circuit Court of Appeals  
For the Ninth Circuit

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WILLIAM COXON,

*Appellant,*

vs.

SOUTHERN PACIFIC COMPANY,  
a corporation,

*Appellee.*

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**BRIEF OF APPELLANT**

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**PRELIMINARY STATEMENT**

This is an appeal by William Coxon, as plaintiff-appellant, from a final judgment of the United States District Court of the District of Arizona, sitting at Phoenix, entered on the 10th day of September, 1945, in favor of defendant following an order granting defendant's motion to dismiss entered July 25th, 1945. (R. 28). The judgment sustained defendant's motion to dismiss plaintiff's complaint, and also dismissed the action. (R. 29). The district judge wrote no opinion.

The action was begun in the Superior Court of the State of Arizona in and for the County of Maricopa by complaint filed in that court on the 26th day of January, 1945, No. 54057, wherein William Coxon was plaintiff and Southern Pacific Company, a corporation, was defendant.\* (R. 2). Plaintiff sought actual and punitive damages against Southern Pacific Company for wrongful discharge.

The action was removed by defendant from the state court to the district court and, after having been duly submitted, was disposed of by order of that court sustaining defendant's motion to dismiss, and by judgment dismissing the action. (R. 28, 29).

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### STATEMENT OF JURISDICTION

#### Jurisdiction of District Court

The complaint filed in the state court on January 26th, 1945, alleges that plaintiff is a resident of the State of Arizona, and that defendant is incorporated under the laws of the State of Kentucky, and is authorized to do business and is doing business as a common carrier by railroad in the State of Arizona. (R. 2). Plaintiff sued the defendant for actual damages in the amount of \$50,000, and punitive damages in the amount of \$50,000. (R. 12). The complaint and summons were served on defendant on January 26th, 1945 (R. 14) and defendant was required to answer within twenty days thereafter.

On February 15th, 1945, which was within defend-

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\*The parties will be referred to in this court as they were in the court below.

ant's time to answer, a verified petition for removal of the action to the United States District Court was filed by defendant in the state court. (R. 15). The petition discloses diversity of residence and citizenship of the adversary parties and the requisite jurisdictional amount. (R. 16). A bond on removal in the principal sum of \$500 was also filed in the state court on February 15th, 1945. (R. 18). The order for removal was dated and entered in the state court on the same day. (R. 21). A transcript of removal proceedings, certified by the clerk of the state court, was lodged in the United States District Court on March 16th, 1945. (R. 22). The verified petition for removal filed in the state court discloses that the action filed there was between plaintiff, who is a resident and citizen of the State of Arizona, and defendant, which is a resident and citizen of the State of Kentucky, and that the action involves more than \$3000, exclusive of interest and costs, and consequently was removable from the state court to the United States District Court as authorized and provided by the laws of the United States.

Secs. 28, 29, Judicial Code, as amended, Title 28, Secs. 71, 72, U.S.C.A.

### **Jurisdiction of this Court**

The jurisdiction of this court is invoked under Sec. 128(a) of the Judicial Code, as amended (Title 28, Sec. 225, U.S.C.A.), which provides:

“(a) Review of Final Decisions. The Circuit Courts of Appeal shall have appellate jurisdiction to review by appeal the final decisions—

First. In the district courts, in all cases save where direct review of the decision may be had in the Supreme Court under section 345 of this title."

Sec. 240-8(c) of the Judicial Code (Title 28, Sec. 230, U.S.C.A.) provides:

"No writ of error or appeal intended to bring any judgment or decree before a circuit court of appeals for review shall be allowed unless application therefor be duly made within three months after the entry of such judgment or decree."

The notice of appeal was filed by plaintiff on the 22nd day of October, 1945 (R. 31) and the bond for costs on appeal was filed the same day. (R. 33). The final judgment was entered the 10th day of September, 1945, and was entered in the clerk's civil docket on the same day. (R. 27). Consequently the appeal from the final judgment of the district court to this court was timely.

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#### STATEMENT OF THE CASE

The case is stated by the complaint. The issues of law are raised by the motion to dismiss which asserted the complaint failed to state a claim against defendant upon which relief can be granted (R. 23), and by the final judgment sustaining the motion to dismiss and dismissing the action. (R. 29). Consequently, the essential facts well pleaded necessary to state a claim upon which relief can be granted are admitted. These facts necessarily are reflected by the complaint, which states the plaintiff's claim for relief, and are as follows:

Plaintiff entered the employ of defendant about June 5th, 1917, as a yard clerk on the Tucson Division of defendant's railroad, and continued that employment in various clerical positions until May 25th, 1944. (R. 3).

The early part of 1944 plaintiff announced his candidacy for nomination (and election) to the office of Governor of Arizona. On February 9th, 1944, he became ill and obtained a leave of absence from his employment, remaining absent upon that account until March 29th, 1944, whereupon in order to conduct his campaign, plaintiff applied for leave of absence until July 31st, 1944. Defendant granted plaintiff leave of absence for ninety days, beginning February 9th, 1944 and ending May 9th, 1944. On April 26th, 1944, plaintiff requested an extension of his leave of absence for ninety days to conduct his campaign, but on May 13th, 1944, defendant instructed plaintiff that by reason of a rule, regulation or order, adopted by defendant by agreement theretofore entered into by defendant and a labor organization known as the Brotherhood of Railway and Steamship Clerks, Freight Handlers, Express and Station Employees, plaintiff's request for further leave of absence was denied and he was instructed to report for duty immediately. (R. 3, 4).

Defendant's refusal to grant the further extension of leave of absence was attributed by defendant to refusal of the labor organization to agree to such extension beyond May 9th, 1944, as provided in the agreement entered into between defendant and the labor organization. (R. 4).

Pursuant to the rule, regulation or order, and the agreement heretofore mentioned, plaintiff's employment

with defendant was declared permanently vacant, and on May 25, 1944, defendant advised plaintiff that his employment was declared permanently vacant. (R. 4).

Plaintiff asserts that defendant, its officers and agents, by enforcing or attempting to enforce the rule, regulation, order or agreement, and by the use of that device or method, attempted to prevent plaintiff from engaging in political activities in the respect heretofore stated, and thereby attempted to deprive plaintiff of civil rights guaranteed to him by the Constitution and laws of Arizona. (R. 4, 5).

The agreement entered into by defendant and the labor organization became effective October 1st, 1940, and provides by Rule 39 thereof as follows:

#### “Leave of Absence

##### Rule 39.

(a) Employees may be granted leave of absence, limited except in case of illness or other physical disability, to ninety (90) calendar days in any calendar year without loss of seniority. Retention of seniority during longer leave of absence may be arranged for by agreement between employing officer and local committee. Leave of absence in excess of thirty (30) calendar days must be in writing. An employee returning from leave of absence shall give at least eight (8) hours' advance notice to his immediate superior of his intention to assume duty on his position.

(b) Members of General or Local Committees, representing employees covered by these rules, will be granted leave of absence without unnecessary delay, and without loss of seniority.” (R. 5).



Rule 810 of the General Rules and Regulations of defendant provides:

“Employees must not engage in any other business without permission from proper officer. They must report for duty at the prescribed time and place and devote themselves exclusively to their duties during prescribed hours.” (R. 6).

In support of his contention that defendant, by enforcing the aforesaid agreement, and by the use of that device or method, attempted to prevent plaintiff from engaging in political activities so as to deprive plaintiff of civil rights guaranteed to him by law, plaintiff pleaded and invoked Sec. 43-1508, Arizona Code Annotated, 1939, which is as follows:

“43-1508. CORPORATION RESTRAINING OR AIDING POLITICAL ACTIVITIES OF EMPLOYEE—PENALTY.—It shall be unlawful for any corporation, its officers or agents, to make, enforce, or attempt to enforce, any order, rule or regulation, or adopt any other device or method to prevent an employee from engaging in political activities, accepting candidacy for nomination or election to, or the holding of political office, or from holding a position as a member of any political committee; or from soliciting or receiving funds for political purposes; or from acting as chairman or participating in a political convention; or assuming the conduct of any political campaign; or for any corporation, its officers or agents to instigate, encourage, aid or assist, whether by personal service or contributing money or anything of value, any employee in its employ to run for or be elected to any political office; or for any corporation, its officers or agents to pay or con-

tribute anything of value, whether in wages, fees or contributions, to any such employee in its employ while such employee is engaged in the official duties of the office to which such employee is elected; or from casting his ballot or vote as his conscience may command. Any employer may suspend the wages or compensation of an employee elected to office when his duties as such officer interfere with his duties as employee. Any person violating any provision of this section shall be guilty of a misdemeanor, and punished, if a corporation, by a fine of not less than five hundred dollars (\$500), nor more than five thousand dollars (\$5,000); and if a natural person by a fine of not less than five hundred dollars (\$500) nor more than five thousand dollars (\$5000), or by imprisonment in the county jail not less than six (6) months nor more than (2) years, or by both such fine and imprisonment." (R. 6, 7).

Plaintiff asserts that from the date of his employment on June 5th, 1917, until his discharge on May 25th, 1944, he had accumulated valuable rights as an employee of defendant, known as "seniority rights," which entitled plaintiff to control and exercise valuable preferences of employment, superior to seniority rights of other employees of defendant who held such rights for a lesser period of time. (R. 8). These seniority rights entitled plaintiff to seek and acquire preference as to the character of service to be performed by him, the location of his employment, the amount of salary he was entitled to earn as well as prestige arising from such rights, which were totally lost by plaintiff's unlawful and wrongful discharge, all to his harm and damage. (R. 8, 9).

Plaintiff asserts that at the time of his discharge he had been employed by defendant for approximately 27 years and had then reached the age of 48 years, and that plaintiff would have been permitted, except for his wrongful discharge, to continue in defendant's employ in the capacity in which he was employed at the time of his discharge, and that he is now disqualified and prohibited from seeking similar employment with other railroad companies or corporations, or for comparable compensation and with the same rights and advantages which he had theretofore enjoyed. (R. 9).

Plaintiff asserts, upon information and belief, that defendant and the aforementioned labor organization, devised and conspired with each other to deprive plaintiff of the opportunity and right to seek nomination and election to the office to which he aspired, because defendant and the labor organization did not desire plaintiff's election as Governor of Arizona, but preferred the election of some other person to that office. (R. 9, 10).

Plaintiff, in addition to the general damages heretofore stated, asserts four items of special damages arising out of—

(a) Loss of the benefits to which he was entitled under the Railroad Retirement Act of 1935 (Title 45, Secs. 215 to 228 inclusive, U.S.C.A.) (R. 10);

(b) Life insurance in the amount of \$2000, payable to plaintiff's family, the cost of which was deducted from plaintiff's monthly salary (R. 10);

(c) Railroad transportation without cost on railroad lines operated in the United States, Canada and Mexico, available to plaintiff and his family, both before and

after plaintiff's retirement, of the annual value of \$300 (R. 11);

(d) Medical and hospital facilities afforded to plaintiff by defendant of the annual value of \$150, for which defendant deducted each month from plaintiff's salary the sum of \$1.75 (R. 12).

As a result of the damages claimed, plaintiff prayed judgment against defendant for actual damages in the sum of \$50,000, and for exemplary damages in the sum of \$50,000.

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#### **STATEMENT OF POINTS RELIED ON IN SUPPORT OF APPEAL**

Plaintiff filed a statement of points in the lower court as required by Rule 75(d) of the Rules of Civil Procedure. (R. 33). The statement of points is adopted by plaintiff in this court in aid of this appeal. (R. 41).

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#### **QUESTION INVOLVED**

The question involved is: Does plaintiff's complaint state a claim upon which relief can be granted against defendant for damages arising out of plaintiff's alleged wrongful discharge by defendant?

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#### **HOW QUESTION IS RAISED**

The question on this appeal is raised by the final judgment of the District Court entered September 10th, 1945, which granted defendant's motion to dismiss plain-

tiff's complaint, and which dismissed the action after the cause had been duly submitted (R. 29, 30), and plaintiff's appeal from that judgment. (R. 31).

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## **SPECIFICATION OF ERRORS**

### **I.**

The judgment of the District Court dismissing this action, following the order of the District Court granting defendant's motion to dismiss the complaint, is contrary to law and is erroneous, for the reason that plaintiff's complaint states a claim against defendant upon which relief can be granted.

### **II.**

The judgment of the District Court sustaining defendant's motion to dismiss, and dismissing the action, is contrary to law and erroneous for the reason that defendant's motion to dismiss the complaint is insufficient in law to constitute a defense to the complaint, and the claim for relief stated by it, because the complaint states a claim against defendant upon which relief can be granted.

### **III.**

The judgment of the District Court, sustaining defendant's motion to dismiss, and dismissing the action, is contrary to law and is erroneous, for the reason that plaintiff's complaint discloses that the discharge of plaintiff by defendant for the reasons set forth in the complaint constituted a breach of plaintiff's contract for which defendant is liable to plaintiff in damages.

## IV.

The judgment of the District Court sustaining defendant's motion to dismiss, and dismissing the action, is contrary to law and erroneous for the reason that defendant's motion to dismiss plaintiff's complaint is insufficient in law to constitute a defense to the complaint and action, and for the reason that the complaint states a claim against defendant upon which relief can be granted in this:

The complaint discloses, as one of the actionable wrongs pleaded, that plaintiff was discharged by defendant upon the asserted violation by plaintiff of defendant's rules and regulations of employment which are in conflict with and in violation of Sec. 43-1508, Arizona Code Annotated, 1939, which secured to plaintiff the right, privilege and prerogative to become a candidate for public office in the State of Arizona unrestricted by any rule or regulation adopted and enforced by defendant in respect to plaintiff's contract of employment with defendant, and further because said law was a valid and subsisting law of the State of Arizona at the time plaintiff was discharged by defendant, and did not offend either the Constitution of the United States or the Constitution of the State of Arizona.

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#### SUMMARY OF THE ARGUMENT

Appellant's argument will be divided into sub-heads which necessarily will cover the four Specification of Errors set forth, *supra*, and will point out the reasons why the complaint states a claim upon which relief can

be granted, particularly when tested by the Federal Rules of Civil Procedure. The following points summarize the reasons why the case should be reversed:

(a) The complaint states a claim upon which relief can be granted for wrongful discharge and consequently the judgment of the District Court sustaining the defendant's motion to dismiss, and dismissing the complaint and the action, is clearly erroneous. (page 14 *infra*)

(b) The seniority rights which plaintiff acquired were valuable property rights and were entitled to the same protection as other property rights, and the wrongful destruction of those rights by defendant is actionable. (page 18 *infra*)

(c) At the time plaintiff was discharged, he was conducting his campaign for the office of Governor of the State of Arizona, and he requested defendant to grant to him a leave of absence in order to conduct and continue his campaign for that office, which defendant refused in violation of Sec. 43-1508, Arizona Code Annotated, 1939, which makes it unlawful for any corporation to make, enforce or attempt to enforce any rule or regulation prohibiting an employee from engaging in political activities or accepting a candidacy for nomination or election to, or the holding of a political office, and prescribing punishment for violation of that provision of the law. The violation of this penal law subjected defendant to damages. (page 23 *infra*)

(d) Section 43-1508, Arizona Code Annotated, 1939, does not impose a limitation and duty upon defendant for the benefit of the public only, but also imposes a limitation and duty upon the defendant for the benefit of the plaintiff who may maintain this action against the defendant for damages

arising from a violation of the statute. (page 32 *infra*)

(e) The complaint is sufficient to state a claim against defendant upon which relief can be granted for tortious conduct so as to justify the claim and award of exemplary damages in addition to actual damages. (page 37 *infra*)

(f) Tested by the rules governing pleadings, the complaint states a claim upon which relief can be granted. (page 40 *infra*)

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### ARGUMENT

- (a) The complaint states a claim upon which relief can be granted for wrongful discharge and consequently the judgment of the District Court sustaining defendant's motion to dismiss, and dismissing the complaint and the action, is clearly erroneous.

(Specification of Errors I, II, p. 11, *supra*.)

Plaintiff entered the employment of defendant on June 5th, 1917 (R. 3) and continued in that employment until May 25th, 1944, when it was declared permanently vacant. (R. 4). Consequently, plaintiff's employment with defendant extended over a period of approximately 27 years (R. 9), during which time plaintiff acquired valuable seniority rights (R. 8), and, in addition, plaintiff, until discharged by defendant, was entitled to benefits of the Railroad Retirement Act; group life insurance; transportation and medical and hospital benefits. (R. 10).

On February 9, 1944, plaintiff became ill and obtained a leave of absence from his duties with defendant and remained absent because of that illness until March



29th, 1944, whereupon plaintiff, in order to conduct his campaign for the office of Governor of Arizona, made application for leave of absence until July 31st, 1944. (R. 3). Defendant granted plaintiff a ninety day leave of absence, *beginning February 9th, 1944*, and ending May 9th, 1944, instead of ending July 31st, 1944, as plaintiff requested.

On April 26th, 1944, plaintiff requested an extension of his leave of absence for ninety days in order to conduct his campaign, but on May 13th, 1944, defendant instructed plaintiff that by reason of a rule, regulation or order adopted by defendant by agreement entered into between defendant and the Brotherhood of Railroad and Steamship Clerks, Freight Handlers, Express and Station Employees, plaintiff's request for further leave of absence was denied and he was instructed to report for duty immediately. (R. 4). Defendant's refusal to grant the extension of leave of absence was attributed by defendant to the refusal of the brotherhood to agree to an extension of plaintiff's leave of absence beyond May 9th, 1944. (R. 4). Accordingly plaintiff's employment with defendant was declared permanently vacant on May 25th, 1944. (R. 4).

Although plaintiff was not a member of the brotherhood, nevertheless defendant invoked the agreement entered into between the defendant and the brotherhood as defendant's justification for the discharge of plaintiff. (R. 5).

*Yazoo & M. V. R.R. Co. v. Webb*, 5 Cir., 64 Fed. 2d 902;

*Yazoo & M. V. R.R. Co. v. Sideboard*, 161 Miss. 4, 133 So. 669;

*McGlohn v. Gulf & S. F. R. Co.* (Miss.), 174 So. 250;

*Rentschler v. Missouri Pacific R.R. Co.*, 126 Neb. 493, 253 N.W. 694, 95 A.L.R. 1, and note beginning at page 41.

Compare:

*Steele v. Louisville & N. R. Co.* (decided Dec. 18, 1944), 323 U.S. 192, 204, 65 Supreme Court Reporter 228 (Adv. Sheets January 1, 1945, Vol. 65—No. 4, p. 226).

Measured by Rule 39 of the agreement which defendant invoked, and the refusal of the brotherhood to agree to an extension of plaintiff's leave of absence, the defendant clearly breached plaintiff's contract of employment as appears from the following allegations of the complaint.

On February 9th, 1944, plaintiff obtained a leave of absence *on account of illness*. He remained absent on that account until March 29th, 1944. (R. 3). At that time he made application to defendant for leave of absence until July 31st, 1944. (R. 3). Defendant granted plaintiff a ninety day leave of absence, but started that leave of absence *from February 9th, 1944*, which was the date plaintiff obtained leave of absence on account of illness. Under Rule 39 of the agreement entered into by defendant and the brotherhood it is provided:

(a) Employees may be granted leave of absence *limited except in case of illness* or other physical disability, to ninety (90) calendar days in any calendar year without loss of seniority. (R. 5). (Emphasis supplied.)

Therefore, measured by the agreement which defendant invoked, plaintiff was entitled, in all events, to leave of absence without limitation of time because of illness. Plaintiff actually obtained a leave of absence on that account on February 9th, 1944, until March 29th, 1944 (R. 3) but in granting plaintiff's additional request for leave of absence, in order to conduct his campaign, defendant granted plaintiff the leave of absence *but dated it from February 9th, 1944*. When plaintiff on April 6th, 1944, requested an extension of leave of absence in order to conduct his campaign for governor, defendant, on May 13th, 1944, instructed plaintiff to report for duty immediately. Failing to do so, plaintiff's employment was declared permanently vacant on May 25th, 1944. (R. 4).

Had defendant, as it was required to do under Rule 39, started plaintiff's requested leave of absence on March 29th, 1944—the day plaintiff's sick leave ended—instead of February 9th, 1944—the day plaintiff's sick leave began—then the ninety days' leave of absence which defendant first granted to plaintiff would have run from March 29th, 1944, until June 29th, 1944. Therefore, when defendant, on May 25th, 1944, declared plaintiff's employment permanently vacant, defendant prematurely discharged plaintiff. Defendant reaffirmed the discharge on September 28th, 1944, which, of course, related back to the wrongful discharge on May 25th, 1944.

- (b) The seniority rights which plaintiff acquired were valuable property rights and were entitled to the same protection as other property rights, and the wrongful destruction of those rights by defendant is actionable.

(Specification of Errors I, II and III, p. 11, *supra*.)

Plaintiff alleges that during his employment with defendant from June 5th, 1917, until his discharge, he had acquired valuable seniority rights which were totally destroyed by his wrongful discharge. (R. 8). These seniority rights were recognized by defendant by Rule 39 of the agreement entered into between defendant and the brotherhood. (R. 5).

The Supreme Court of Arizona has held that seniority rights are property rights and are as much entitled to protection in case they are invaded as other physical property rights.

*Grand International Brotherhood of Locomotive Engineers v. Mills*, 43 Ariz. 379, 31 P.2d 971.

Addressing itself to this question, the Supreme Court of Arizona (31 P.2d 979) said:

“Let us then consider more carefully the nature of this seniority right, and whether it falls within the definition of property as above set forth. It is only by means of his labor that the average man can earn the wherewithal to support himself and his family, and perchance, if he is fortunate and frugal, make investments which will provide for his old age. Such being the case, it is of vital importance to those who work for salary or wages, and they constitute a large and constantly increasing part of our citizens, that their opportunity to work be as constant, certain, and lucrative as possible. Any-

thing which tends to promote this increases the earning power of the worker, while anything which tends to diminish it is as great an attack upon his means of livelihood as would be the actual destruction of the physical property through which the wealthier and more fortunate individual obtains his income. A study of the reason for, and the history of, the seniority rule which, although best known among railroad men, is growing more and more in favor among the workers in every class, makes this clear. So long as the contract of employment between a corporation and its hundred and thousands of employees provides for seniority, it is in effect unemployment insurance which the worker has purchased by his years of faithful service. Essentially it is as much a part of his wages as though he received an increase therein and used the increase to buy such insurance therewith. Ten years of service gives him a far greater certainty of retaining his employment than is obtained by one year of service, and in times of fluctuating employment particularly this is of great money value. The very fact that, as the record reveals, the matter was fought so bitterly within the ranks of the brotherhoods themselves, shows that it is not a mere imaginary or sentimental interest which plaintiffs are seeking to protect, but something which may mean the difference between poverty and a competence, between public aid and a self-respecting and independent home. We believe that a seniority right is, under the true principles of equity, as much entitled to protection in case it is invaded as any physical property right which is known."

The courts are in agreement that seniority rights are valuable property rights and are accorded that full measure of protection which is accorded to other property rights.

*Brand v. Pennsylvania Railroad Co.* (D.C.P.A.),  
22 Fed. Supp. 569;

*Carver v. Brien*, 315 Ill. App. 643, 43 N.E.2d 597;

*Donovan, et al. v. Travers*, 285 Mass. 167, 188  
N.E. 705;

*Samuelson v. Brotherhood of Railroad Trainmen*  
(Wyo.), 151 Pac.2d 347.

Moreover, that the right to work and to earn a livelihood is protected by the 14th Amendment to the Constitution of the United States is firmly established by the Supreme Court of the United States.

*Truax v. Raich*, 239 U.S. 33, 36 S.Ct. 7, 60 L.Ed.  
131.

In that case legislation enacted under the initiative provision of the Constitution of Arizona sought, in instances where five or more workers were employed, to limit employment to not less than eighty per cent qualified electors or native-born citizens, thereby excluding in such cases the employment of aliens. The law was held unconstitutional by the Supreme Court, and in the course of the opinion the Supreme Court said (239 U.S. 38, 41):

“\* \* \* The right to earn a livelihood and to continue in employment unmolested by efforts to enforce void enactments should similarly be entitled to protection (safeguarding of rights of property)

in the absence of adequate remedy at law. It is said that the bill does not show an employment for a term, and that under an employment at will the complainant could be discharged at any time, for any reason or for no reason, the motive of the employer being immaterial. The conclusion, however, that is sought to be drawn, is too broad. The fact that the employment is at the will of the parties, respectively, does not make it one at the will of others.”

\* \* \* \*

“\* \* \* It requires no argument to show that the right to work for a living in the common occupations of the community is of the very essence of the personal freedom and opportunity that it was the purpose of the Amendment to secure.”

See, also:

*Nord v. Griffin*, Cir. 7, 86 Fed.2d 481; cert. den., 300 U.S. 673, 57 Sup. Ct. 612, 81 L.Ed. ...., 2 case which involved a controversy over seniority rights.

Plaintiff alleges that at the time of his discharge he had reached the age of 48 years, but that notwithstanding his age, he would have been permitted, except for his wrongful discharge, to continue in the capacity he was employed at the time of his discharge. (R. 9).

Thus plaintiff's employment was more than an employment subject to termination at the will of defendant. In fact, Rule 39 provides that plaintiff's seniority rights could have been retained during longer periods of absences when arranged for by agreement of the employing officer and the local committee of the brotherhood. (R. 5).

The complaint construed in its entirety discloses that the employment here was surrounded with rights and privileges which did not permit the termination of the employment either at the will of the defendant or by direction given by the brotherhood to the defendant.

“Where no definite term of employment is expressed, there is no inflexible rule governing the duration of the relationship. In such cases, the duration of the employment must be determined by circumstances in each particular case. It is dependent upon the understanding and intent of the parties, to be ascertained from their written or oral negotiations, the usages of business, the situation and object of the parties, the nature of the employment, and all the circumstances surrounding the transaction. Regardless, therefore, of the absence of any express stipulation regarding the term of employment, a dispute as to the duration of a contract of employment is to be settled with reference to the terms of the contract, the nature of the services which were agreed to be performed, and the attending circumstances which evidence the intention of the parties, and this is true where the contract is in writing, as well as where it is oral; in either case, the court takes into consideration the situation of the parties, and the objects they had in view. In case the contract has been made with reference to a general custom or business usage which enters into and becomes a part of the agreement, the contract is not, of course, indefinite as to its duration if such custom or usage fixes the term of the employment.”

35 *Am. Jur.* (Master and Servant), Sec. 19, p. 457.



See:

*Putnam v. Producers Livestock Marketing Assoc.*,  
256 Ky. 196, 75 S.W.2d 1075, 100 A.L.R. 828,  
note pages 834, 841.

- (c) At the time plaintiff was discharged, he was conducting his campaign for the office of governor of the State of Arizona, and he requested defendant to grant to him a leave of absence in order to conduct and continue his campaign for that office, which defendant refused in violation of Sec. 43-1508, Arizona Code Annotated, 1939, which makes it unlawful for any corporation to make, enforce or attempt to enforce any rule or regulation prohibiting an employee from engaging in political activities or accepting a candidacy for nomination or election to, or the holding of a political office, and prescribing punishment for violation of that provision of the law. The violation of this penal law subjected defendant to damages.

(Specification of Errors IV, p. 12, *supra*.)

Section 43-1508, Arizona Code Annotated, 1939, provides as follows:

“43-1508. CORPORATION RESTRAINING OR AIDING POLITICAL ACTIVITIES OF EMPLOYEES—PENALTY.—It shall be unlawful for any corporation, its officers or agents, to make, enforce, or attempt to enforce, any order, rule or regulation, or adopt any other device or method to prevent an employee from engaging in political activities, accepting candidacy for nomination or election to, or the holding of political office, or from holding a position as a member of any political committee; or from soliciting or receiving funds for political purposes; or from acting as chairman or participating in a political convention; or assuming the conduct of any political

campaign; or for any corporation, its officers or agents to instigate, encourage, aid or assist, whether by personal service or contributing money or anything of value, any employee in its employ to run for or be elected to any political office; or for any corporation, its officers or agents to pay or contribute anything of value, whether in wages, fees or contributions, to any such employee in its employ while such employee is engaged in the official duties of the office to which such employee is elected; or from casting his ballot or vote as his conscience may command. Any employer may suspend the wages or compensation of an employee elected to office when his duties as such officer interfere with his duties as employee. Any person violating any provision of this section shall be guilty of a misdemeanor, and punished, if a corporation, by a fine of not less than five hundred dollars (\$500), nor more than five thousand dollars (\$5,000); and if a natural person by a fine of not less than five hundred dollars (\$500) nor more than five thousand dollars (\$5,000), or by imprisonment in the county jail not less than six (6) months nor more than two (2) years, or by both such fine and imprisonment."

Defendant's conduct in discharging plaintiff was in direct violation of the foregoing law. The law was enacted by the Legislature of Arizona in 1923 as Chapter 10 of the laws of that legislative session, as appears from the annotation at the end of Section 43-1508, *supra*. Rule 39 of the agreement entered into between defendant and the brotherhood became effective October 1st, 1940, (R. 5). Thus the law antedates the rule by approxi-

mately 17 years. It prohibits all corporations from interfering with the political activities and ambitions of its employees. It is a valid exercise of the police power of the state and offends no constitutional provision of the State of Arizona or of the United States. The law operates equally upon all corporations, domestic and foreign.

The validity of the enactment in its application to defendant as a corporation is sustained by analogous decisions of the Supreme Court of the United States.

*Prudential Insurance Co. v. Cheek*, 259 U.S. 530, 42 S.Ct. 516, 66 L.Ed. 1044, 27 A.L.R. 27, 39;  
*Chicago, R. I. & P. Co. v. Perry*, 259 U.S. 548, 42 S.Ct. 524, 66 L.Ed. 1056.

In *Prudential Insurance Co. v. Cheek*, *supra*, the Supreme Court had occasion to construe a law of Missouri which required corporations only to issue to their employees a service letter setting forth the nature and character of services rendered by the employee and the duration thereof, and truly stating for what cause the employee quit the service. Failure to issue the letter constituted a misdemeanor punishable by fine and imprisonment. Cheek sued the Prudential Insurance Company for damages arising out of the violation of the law by the insurance company. The company attacked the constitutionality of the law upon the claim that it deprived corporations of due process and equal protection of the law in violation of the Fourteenth Amendment. The Supreme Court of Missouri sustained the law notwithstanding these constitutional objections and

reversed the judgment of the lower court. 192 S.W. 387. On retrial, the employee was awarded judgment and the insurance company again appealed to the Supreme Court of Missouri which transferred the case to the Court of Appeals for final disposition. 209 S.W. 928. That court affirmed the judgment of the lower court. 223 S.W. 754. On writ of error the Supreme Court of the United States sustained the judgment in favor of the employee, and the judgment of the Missouri court, and said (259 U.S. 536 and 546):

“That freedom in the making of contracts of personal employment, by which labor and other services are exchanged for money or other forms of property, is an elementary part of the rights of personal liberty and private property, not to be struck down directly, or arbitrarily interfered with, consistently with the due process of law guaranteed by the 14th Amendment, we are not disposed to question. This court has affirmed the principle in recent cases. *Adair v. United States*, 208 U.S. 161, 174, 52 L.Ed. 436, 442, 28 Sup. Ct. Rep. 277, 13 Ann. Cas. 764; *Coppage v. Kansas*, 236 U.S. 1, 14, 59 L.Ed. 441, 446, L.R.A. 1915C, 960, 35 Sup. Ct. Rep. 240.

“But the right to conduct business in the form of a corporation, and, as such, to enter into relations of employment with individuals, is not a natural or fundamental right. It is a creature of the law; and a state, in authorizing its own corporations or those of other states to carry on business and employ men within its borders, may qualify the privilege by imposing such conditions and duties as reasonably may be deemed expedient, in order that the corporation’s activities may not operate to

the detriment of the rights of others with whom it may come in contact.”

\* \* \* \*

“It is not for us to point out the grounds upon which the state legislature acted, or to indicate all the grounds that occur to us as being those upon which they may have acted. We have not attempted to do this; but merely to indicate sufficient grounds upon which they reasonably might have acted, and possibly did act, to show that it is not demonstrated that they acted arbitrarily, and hence that there is no sufficient reason for holding that the statute deprives the corporation of its liberty or property without due process of law.

“The argument under the ‘equal protection’ clause is unsubstantial. As we are assured by the opinion of the supreme court, the mischiefs to which the statute is directed are peculiarly an outgrowth of existing practices of corporations, and are susceptible of a corrective in their case not so readily applied in the case of individual employers, presumably less systematic in their methods of employment and dismissal. There is no difficulty, therefore, in sustaining the legislature in placing corporations in one class and individuals in another. See *Mallinckrodt Chemical Works v. Missouri*, 238 U.S. 41, 55, 56, 59 L.ed. 1192, 1198, 35 Sup. Ct. Rep. 671. And the act applies to all corporations doing business in the state, whether incorporated under its laws or not.”

Compare:

*Asbury Hospital v. Cass County, N. D.*, 66 S.Ct. 61, 65 (decided Nov. 5, 1945).

In *Chicago, R. I. & P. Co. v. Perry, supra*, the Supreme Court of the United States had occasion to construe a statute of Oklahoma which was substantially like the statute of Missouri. The Oklahoma statute was sustained by the Supreme Court as a valid exercise of the police power of the state, notwithstanding the statute applied only to public service corporations. A trial by jury in the lower state court resulted in a judgment awarding damages to the plaintiff-employee arising out of the failure of the railroad company to give to the employee the service letter required by the Oklahoma penal statute. The judgment was affirmed by the Supreme Court of Oklahoma.

*Dickinson v. Perry*, 70 Okla. 25, 181 Pac. 504.

In disposing of the contention that the Oklahoma statute deprived the railroad company of due process of law and the equal protection of the law, the Supreme Court followed *Prudential Insurance Co. v. Cheek, supra*, and in the course of the opinion, by the last paragraph thereof, said:

“The contention that the Service Letter Law denies to plaintiff in error the equal protection of the laws is rested upon the fact that it is made to apply to public service corporations (and contractors working for them), to the exclusion of other corporations, individuals, and partnerships said to employ labor under similar circumstances. This is described as arbitrary classification. We are not advised of the precise reasons why the legislature chose to put the policy of this statute into effect as to public service corporations, without going further; nor is it worth while to inquire. It may

have been that the public had a greater interest in the personnel of the public service corporations, or that the legislature deemed it expedient to begin with them as an experiment—or any one of a number of other reasons. It was peculiarly a matter for the legislature to decide, and not the least substantial ground is present for believing they acted arbitrarily. We feel safe in relying upon the general presumption that they ‘knew what they were about.’ *Middleton v. Texas Power & Light Co.*, 249 U.S. 152, 157, 158, 63 L.ed. 527, 531, 39 Sup. Ct. Rep. 227, and cases cited.”

The two cases last cited construed and sustained statutes of Missouri and Oklahoma which in principle are not unlike Section 43-1508, Arizona Code Annotated, 1939, *supra*. Each supports a civil action for damages arising out of its violation, although a violation of the statute is punishable by fine and imprisonment.

The privilege of becoming a candidate for public office is unquestionably a higher right than the right to receive a service letter upon the termination of employment. Aspiration to public office is essential to the preservation of a democratic form of government.

Defendant’s “Motion to Dismiss Action” under the old practice, and prior to the advent of the Rules of Civil Procedure, would be akin to a special demurrer because it sets forth specifically ten purported grounds why “the complaint fails to state a claim against defendant upon which relief can be granted.” (R. 23-25).

Ground (8) is that Section 43-1508, Arizona Code Annotated, violates, in addition to the Fourteenth Amendment to the Constitution of the United States, Article

II, Section 4, Constitution of Arizona, in that it deprives defendant of its liberty and property without due process of law. (R. 24). Section 43-1508, *supra*, does not conflict with the due process clause of the Arizona Constitution in any particular. See:

*State v. Dominion Hotel, Inc.*, 17 Ariz. 267, 151 Pac. 958 (affirmed 249 U.S. 265, 63 L.ed. 597, 39 S.Ct. 273);

*Dominion Hotel Inc. v. State*, 18 Ariz. 345, 161 Pac. 682;

*Haddad et al. v. State*, 23 Ariz. 105, 201 Pac. 847;  
*Stargo Mines Company v. Coffee Adm.*, 28 Ariz. 527, 238 Pac. 335;

*State etc. v. Price et al.*, 49 Ariz. 19, 63 Pac.(2) 653.

Unlike the statute stricken down in *State v. Mender-son*, 57 Ariz. 103, 111 Pac.(2) 622, Section 43-1508, *supra*, is definite and certain and sufficiently explicit to inform defendant what conduct on its part will render it liable. The challenged statute does not violate the due process clause of either the Federal or State Constitutions.

Subdivision (9) of the Motion to Dismiss advances the theory that Section 43-1508, *supra*, conflicts with Article II, Section 13, and Article IV, part 2, Section 19, subsections 7 and 13, of the Arizona Constitution, in that it grants to citizens and classes of citizens, privileges and immunities which, upon the same terms, do not equally belong to defendant thereunder. (R. 24, 25).

Article II, Section 13, *supra*, reads:



“(Equal operation of laws)—No law shall be enacted granting to any citizen, class of citizens, or corporation other than municipal, privileges or immunities which, upon the same terms, shall not equally belong to all citizens or corporations.”

Article IV, part 2, Section 19, *supra*, relied upon by defendant in its Motion to Dismiss, reads:

“No local or special laws shall be enacted in any of the following cases, that is to say:

\* \* \* \*

7. Punishment of crimes and misdemeanors.

\* \* \* \*

13. Granting to any corporation, association, or individual, any special or exclusive privileges, immunities, or franchises.”

The statute is not local or special in any sense of the word. It applies to all corporations, and their officers and agents. A corporation, of course, can only act through its officers and agents. The statute operates equally upon all the classes mentioned therein. It is within the power of the legislature to determine the evil, under the state's police powers, and to remedy that evil. (*Dominion Hotel, Inc. v. State*, 249 U.S. 265, 63 L.ed. 597, 39 S.Ct. 273, *supra*).

The Supreme Court of Arizona has many times passed upon the equal protection clauses of the Arizona Constitution. The cases from that court will uphold the challenged statute. See:

*Hazas v. State*, 25 Ariz. 453, 219 Pac. 229;

*Haddad et al. v. State*, 23 Ariz. 105, 201 Pac. 847;

*Hunt v. Mohave County*, 18 Ariz. 480, 162 Pac. 600;

*Stargo Mines Co. v. Coffee, Adm.*, 28 Ariz. 527,  
238 Pac. 335;

*State v. Hooker*, 45 Ariz. 202, 41 Pac.(2) 1091;

*State v. Dominion Hotel, Inc.*, 17 Ariz. 267, 151  
Pac. 958;

*Coggins v. Ely*, 23 Ariz. 155, 202 Pac. 391;

*Morris v. State*, 40 Ariz. 32, 9 Pac.(2) 404;

*Fairfield v. Huntington*, 23 Ariz. 528, 205 Pac.  
814.

- (d) Section 43-1508, Arizona Code Annotated, 1939, does not impose a limitation and duty upon defendant for the benefit of the public only, but also imposes a limitation and duty upon the defendant for the benefit of the plaintiff who may maintain this action against the defendant for damages arising from a violation of the statute.

(Specification of Error IV, p. 12, *supra*.)

Section 43-1508, Arizona Code Annotated 1939, inflicts a penalty of fine and imprisonment for its violation. Under a statute which imposes a duty for the benefit of particular individuals, or classes of individuals, any one within the benefit of the statute who sustains an injury by reason of a breach thereof, has a right of action against the person guilty of the breach, and the right of action is not affected by the fact that the statute also makes the breach of duty a criminal offense.

That question was raised in *Cheek v. Prudential Insurance Co.*, *supra*, on the first appeal of the case to the Supreme Court of Missouri, and was carefully considered by that court. 192 S.W. 387, 389, 390. In disposing of the question, the Supreme Court of Missouri said:

“The position of counsel for the plaintiff is that where the duty imposed by the statute is merely

for the benefit of the public, and a fine or penalty is imposed for breach thereof, no right of action is given thereby to the individual who has been damaged by its breach; but if the duty imposed is also for the benefit of a class of individuals, a right of action is also given thereby to any one of that class who may be damaged by the breach of that duty; and, the plaintiff having been an employe of the defendant for more than 90 days, and this statute having been enacted for the benefit and protection of all employes of all corporations, it gives him a cause of action against the defendant for the damage he sustained by its breach. The best and clearest rule I have been able to find governing the construction of such statutes is stated in 1 Corpus Juris, p. 957, in the following language:

‘The true rule is said to be that the question should be determined by a construction of the provisions of the particular statute and according to whether it appears that the duty imposed is merely for the benefit of the public and the fine, or penalty, a means of enforcing its duty and punishing a breach thereof, or whether the duty imposed is also for the benefit of particular individuals, or classes of individuals. If the case falls within the first class, the public remedy by fine, or penalty, is exclusive, but if the case falls within the second class a private action may be maintained, particularly where the injured party is not entitled, or not exclusively entitled, to the penalty imposed.’ ”

“Cases from various states are cited in support of this rule. In 1 Corp. Jur. 952, it is said:

‘It is a general rule that wherever a statute imposes a duty for the benefit of particular indi-

viduals, or classes of individuals, any one within the benefit of the statute who sustains an injury by reason of a breach thereof has a right of action against the person guilty of the breach. The private right of action is not affected by the fact that the statute also makes such breach of duty a criminal offense.' "

"In a note, 9 L.R.A. (N.S.) 338, to the case of *Wolf v. Smith*, the subject is fully discussed and numerous cases are cited. In the case of *Parker v. Barnard*, 135 Mass. 116, 46 Am. Rep. 450, it is said:

'When an act is commanded or forbidden under a statutory penalty, and a failure to do the act enjoined, or the doing of the act prohibited, causes an injury, the party offending is liable to the party injured for the injury caused by his default, notwithstanding he may also have incurred the penalty.' "

"The courts of this state have repeatedly spoken in no uncertain tones upon this question. In the case of *Drain v. Railway Co.*, 10 Mo. App. 531; *Id.*, 86 Mo. 574, the court, in substance, said: A failure to perform a duty enjoined by statute or ordinance is negligence as a matter of law, for which a recovery may be had by any person injured by reason thereof. To the same effect are the following cases: *Hanlon v. Mo. Pac. Ry. Co.*, 104 Mo. 381, 16 S.W. 22; *Graitiot v. Railway Co.*, 116 Mo. 450, 21 S.W. 1094, 16 L.R.A. 189; *Karle v. Railway Co.*, 55 Mo. 476; *Easley v. Railroad Co.*, 113 Mo. 236, 20 S.W. 1073; *Fortune v. Railway Co.*, 10 Mo. App. 252; *Brannock v. Elmore*, 114 Mo. 55, 21 S.W. 451; *Hutchinson v. Railway Co.*, 161 Mo. 246, 61 S.W. 635, 852, 84 Am. St. Rep. 710; *Jackson v. Railway*

Co., 157 Mo. 621, 58 S.W. 32, 80 Am. St. Rep. 650; Weller v. Railway Co., 164 Mo. 181, 64 S.W. 141, 86 Am. St. Rep. 592; Eckhard v. Transit Co., 190 Mo. 593, 89 S.W. 602; Holland v. Railway Co., 210 Mo. 338, 109 S.W. 19; Reeves v. Railway Co., 251 Mo. 169, 158 S.W. 2; Lyons v. Corder, 253 Mo. 539, 162 S.W. 606. In the case of Union Pacific Ry. Co. v. McDonald, 152 U.S. 262, 14 Sup. Ct. 619, 38 L.Ed. 434, the court said:

‘The violation of a duty enjoined by statute imposed for the public benefit entitles one injured thereby to an action for damages.’ ”

“To the same effect are: Ohio & M. R. Co. v. McGehee, 47 Ill. App. 348; Noble v. Richmond, 31 Grat. (72 Va.) 271, 31 Am. Rep. 726; Platte & D. Co. v. Dowell, 17 Colo. 376, 30 Pac. 68; O'Donnell v. Providence, etc., Co., 6 R.I. 211. In the case of Terre Haute, etc., Co. v. Williams, 69 Ill. App. 393, affirmed 172 Ill. 379, 50 N.E. 116, 64 Am. St. Rep. 44, the court said:

‘Whenever a duty arises, whether upon common law or statutory grounds, an action will lie for a breach thereof in favor of any one injured by reason of such breach.’ ”

“To the same effect is Osborne v. McMasters, 40 Minn. 103, 41 N.W. 543, 12 Am. St. Rep. 698. In the case of Gray v. McDonald, 104 Mo. 303, 16 S.W. 398, it was held that:

‘The right of action for an injury done in the commission of a felony or misdemeanor is not merged in the public offense.’ ”

“In the case of Baxter v. Coughlin, 70 Minn. 1, 72 N.W. 797, it was held that:

‘A director of a bank receiving deposits while insolvent was liable to the depositor suffering loss, notwithstanding the penalty provided in the statute.’ ”

The decision of the Supreme Court of Missouri in the foregoing respect was adverted to by the Supreme Court of the United States in its decision in:

*Prudential Insurance Co. v. Cheek*, 259 U.S. 530, 533, 42 S.Ct. 516, 66 L.Ed. 1044, 1049.

We also direct the court's attention to the following decision:

*Lockheed Aircraft Corporation v. Superior Court in and for Los Angeles County*, 153 Pac.2d 966.

In that case, a District Court of Appeals of California (hearing denied February 1st, 1945, by the Supreme Court of California) held that an employee suffering injury caused by the employer violating a penal statute which prevented the employer from making and enforcing rules prohibiting the employee from engaging in politics or controlling their political activities, has a civil remedy for damages against the employer for violating the statute. A companion statute provided that nothing in the chapter of which the criminal statute was a part prevented the injured employee from recovering damages from his employer for a violation of the criminal statute. The District Court of Appeal indicated by the decision that an action for damages would lie in the absence of a statute expressly conferring that remedy. 153 Pac.2d 972.

We have heretofore shown by decisions of the Supreme Court of the United States, and other courts, that violation of a criminal statute resulting in an injury to property rights supports a cause of action by the person injured for damages, although the statute does not expressly confer that remedy.

See, also:

- In re Debs*, 158 U.S. 594, 15 S.Ct. 900, 910, 39 L.Ed. 1106;
- 1 *C.J.*, pp. 952, 954, 957;
- 1 *C.J.S.*, pp. 994, 996;
- 1 *Amer. Jur.*, p. 432.

- (e) The complaint is sufficient to state a claim against defendant upon which relief can be granted for tortious conduct so as to justify the claim and award of exemplary damages in addition to actual damages.

(All Specification of Errors.)

Since the complaint states a claim upon which relief can be granted, plaintiff is entitled to recover compensation for the injuries he has sustained. This is an axiomatic rule of law not admissible of dispute.

15 *Am. Jur.*, p. 442.

Furthermore, under the facts, as disclosed by the complaint, plaintiff is entitled to recover exemplary damages from defendant.

- Philadelphia W. & B. R. Co. v. Quigley*, 21 How. 202, 213, 214, 16 L.Ed. 73;
- Day v. Woodworth*, 13 How. 363, 371, 14 L.Ed. 181;

*Lake Shore & M. S. Ry. Co. v. Prentice*, 147 U.S.  
101, 107, 13 S.Ct. 261, 37 L.Ed. 97;  
*U. S. v. Hess*, 317 U.S. 537, 549, 63 Sup. Ct. 379,  
87 L.Ed. 443.

See:

*Green v. Keithley*, 8 Cir., 86 Fed.2d 238.

The case last cited comprehensively reviews the authorities from the Federal courts on the question.

*Day v. Woodworth*, *supra*, is the leading case on the question in the Federal courts. That was an action for damages for trespass, and holds that exemplary damages are allowable in that type of cases. The Supreme Court extended the rule to all actions for torts and said:

“It is a well established principle of the common law, that in actions of trespass *and all actions on the case for torts*, a jury may inflict what are called exemplary, punitive, or vindictive damages upon a defendant, having in view the enormity of his offence rather than the measure of compensation to the plaintiff. We are aware that the propriety of this doctrine has been questioned by some writers; but if repeated judicial decisions for more than a century are to be received as the best exposition of what the law is, the question will not admit of argument. By the common as well as by statute law, men are often punished for aggravated misconduct *or lawless acts*, by means of a civil action, and the damages inflicted by way of penalty or punishment, given to the party injured. In many civil actions, such as libel, slander, seduction, &c., the wrong done to the plaintiff is incapable of being measured by a money standard; and the damages assessed depend on the circumstances, showing the



degree of moral turpitude or atrocity of the defendant's conduct, and may properly be termed exemplary or vindictive rather than compensatory." (Italics supplied.)

There is no statute in Arizona treating with exemplary damages in tort actions and accordingly the allowance of exemplary damages in the Federal courts is a matter of general law which Federal courts determine for themselves.

*Green v. Keithley, supra.*

In *Philadelphia W. & B. R. Co. v. Quigley, supra*, the Supreme Court again reaffirmed the allowance of exemplary damages in tort cases. Although the Supreme Court held that exemplary damages could not be recovered in that particular case, nevertheless the court said (21 How. 213, 214):

"In *Day v. Woodworth*, 13 How. S.C.R., 371, this court recognized the power of a jury in certain actions of tort to assess against the tort-feasor punitive or exemplary damages. Whenever the injury complained of has been inflicted maliciously or wantonly, and with circumstances of contumely or indignity, the jury are not limited to the ascertainment of a simple compensation for the wrong committed against the aggrieved person. But the malice spoken of in this rule is not merely the doing of an unlawful or injurious act. The word implies that the act complained of was conceived in the spirit of mischief, or of criminal indifference to civil obligations. \* \* \*" (Emphasis supplied.)

Here we have a reckless disregard by defendant of the contractual rights of plaintiff and also the inex-

cusable violation by defendant of a penal statute. Besides, the complaint alleges that the defendant and the brotherhood entered into a conspiracy to deprive plaintiff of the opportunity to become a candidate for public office. (R. 9, 10).

The complaint, in all its aspects, discloses that plaintiff is legally justified in claiming exemplary damages, measured by the decisions cited above, and by the decisions of the Supreme Court of Arizona.

See:

*Ross v. Clark*, 35 Ariz. 60, 274 Pac. 639;

*Gila Water Co. v. Gila Land & Cattle Co.*, 30 Ariz. 569, 249 Pac. 751.

(f) Tested by the new rules governing pleadings, the complainant states a claim upon which relief can be granted.

(All Specification of Errors.)

The judgment of the District Court, unless reversed, disposes of the case. This summary disposition of the case should not stand unless the complaint in every respect is legally insufficient to state a claim upon which relief can be granted. There are definite, well-settled rules of pleading which now measure the sufficiency of the complaint. They are stated in:

*Carroll v. Morrison Hotel Corporation*, 7 Cir., 149 Fed.2d 404, 406:

“On a motion to dismiss on the ground that the complaint does not state a claim on which relief can be granted, the rule is that *the complaint must be viewed in the light most favorable to plaintiff* and the truth of all facts well pleaded, admitted, *Galbreath v. Metropolitan Trust Co.*, 10 Cir., 134

F.2d 569. This includes facts alleged on information and belief. There is no specific provision covering such allegations in the Federal Rules of Civil Procedure, but Rule 8(f) states that 'All pleadings shall be so construed as to do substantial justice'; consequently to refuse to give credence to them on defendant's motion to dismiss would be opposed to the spirit of the Rules. Furthermore, Rule 11 provides that the signature of an attorney to the pleadings is a certificate that 'to the best of his knowledge, information, and belief,' there appears to be good ground to support the pleading; so the concept of 'information and belief' is recognized under the Rules, and there appears to be no good reason why such pleading is not permissible, as in the instant case, where the matters are peculiarly within the knowledge of the defendants.

"It has also been held that the complaint should not be dismissed unless it appears certain that plaintiff is not entitled to relief under any state of facts which could be proved in support thereof, *Leimer v. State Mut. Life Assur. Co.*, 8 Cir., 108 F.2d 302, and *Tahir Erk v. Glenn L. Martin Co.*, 4 Cir., 116 F.2d 865. No matter how likely it may seem that the pleader will be unable to prove his case, he is entitled, upon averring a claim, to an opportunity to try to prove it, *Continental Collieries v. Shober*, 3 Cir., 130 F.2d 631, 635.'" (Emphasis ours.)

In *Dioguardi v. Durning, etc.*, 2 Cir., 139 Fed.2d 774, 775, the Court, in passing on the sufficiency of a complaint ("obviously home-drawn") to withstand a motion to dismiss, said:

"\* \* \* Under the new rules of civil procedure, there is no pleading requirement of stating 'facts

sufficient to constitute a cause of action,' but only that there be 'a short and plain statement of the claim showing that the pleader is entitled to relief.' Federal Rules of Civil Procedure, Rule 8(a), 28 U.S.C.A. following Section 723c; and the motion for dismissal under Rule 12(b) is for failure to state 'a claim upon which relief can be granted.' The District Court does not state why it concluded that the complaints showed no claim upon which relief could be granted; \* \* \*\*

See, also:

*Burley, et al. v. Elgin J. & E. Ry.*, 7 Cir., 140 Fed. 2d 488, 490;

*Kohler et al. v. Jacobs et al.*, 5 Cir., 138 Fed.2d 440, 443;

*Hannah v. Gulf Power Co.*, 5 Cir., 128 Fed.2d 930, 931;

*Plunkett v. Abraham Brothers Packing Co., Inc.*, 6 Cir., 129 Fed.2d 419, 421;

*Bell v. Preferred Life Assur. Soc. of Montgomery, Ala. et al.*, 320 U.S. 238, 64 S.Ct. 5;

*De Loach et al. v. Crowley's Inc.*, 5 Cir., 128 Fed. 2d 378, 380;

Rule 54(c), *Federal Rules of Civil Procedure*.

The books are replete with decisions upholding claims for relief when tested by Rule 8 of the Federal Rules of Civil Procedure. If it is held by this Honorable Court that the complaint in the case at bar fails to state a claim upon which relief can be granted, the holding will necessarily have to be based on the merits of the claim and not on the form in which the claim is pleaded. (Con-

*tinental Collieries v. Shober*, 3 Cir., 130 Fed.2d 631, 635).

It is our firm conviction that if the Federal Rules of Civil Procedure were not now in effect, that under the old practice the motion to dismiss (demurrer) should not have been sustained.

*Polk v. Glover*, 305 U.S. 5, 59 S.Ct. 15;

*Borden's Farm Products v. Baldwin, etc.*, 293 U.S. 294, 55 S.Ct. 187;

*Picking et al. v. Pennsylvania R. Co. et al.*, 3 Cir., 151 Fed.2d 240, 244.

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### CONCLUSION

We think the complaint states a claim against defendant upon which relief can be granted and that the judgment of the trial court sustaining defendant's motion to dismiss the complaint, and dismissing the action, is erroneous.

It is prayed, therefore, that the judgment of the District Court be reversed.

Respectfully submitted,

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IN THE  
United States  
Circuit Court of Appeals  
For the Ninth Circuit

WILLIAM COXON,

*Appellant,*

vs.

SOUTHERN PACIFIC COMPANY,  
a corporation,

*Appellee.*

**Appellee's Brief**

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IN THE  
**United States**  
**Circuit Court of Appeals**  
**For the Ninth Circuit**

---

**WILLIAM COXON,**

*Appellant,*

vs.

**SOUTHERN PACIFIC COMPANY,**  
a corporation,

*Appellee.*

---

**Appellee's Brief**

---

**CONCERNING STATEMENT OF THE CASE**

Plaintiff's statement of the case is inaccurate in one respect, i. e., on pages 5 and 8 he states that he continued in defendant's employment until May 25, 1944, and that he was discharged on that date, whereas the date of discharge, as alleged in the complaint (R. 3, 4, 8, 9), was September 28, 1944. The state-

ment is challenged as a suggestion that he was discharged twelve days after he was notified to report for duty, but the alleged fact is that he was not actually discharged until four months later. The date May 25, 1944, is alleged to be the date of declaration of vacancy of his employment pursuant to Rule 39 of the collective labor agreement, which rule pertains to the loss of seniority but has no application to discharge from employment (R. 5).

The statement of the case should be augmented to include the following recital:

(1) This is a suit for alleged wrongful discharge of plaintiff from defendant's employ (R. 8, 10, 12).

(2) The complaint sounds in tort (R. 7, 8, 12).

(3) The Brotherhood is not a party to the suit.

(4) Neither the Constitution nor laws of the United States are involved, as plaintiff invokes only the State Constitution and laws (R. 5, 7, 8).

(5) The gist of the complaint is that defendant violated *Section 43-1508, Arizona Code Annotated, 1939*, and that plaintiff has a claim thereunder (R. 6, 7, 8).

(6) Judgment of dismissal of the suit was entered after plaintiff declined to plead further (R. 33).

## SUMMARY OF ARGUMENT

(1) **No legitimate issue exists as to seniority rights and exemplary damages**, because these matters relate to the measure of damages and are subjects for consideration only in the event that an actionable claim is stated, and for the further reason that plaintiff

sues for alleged wrongful discharge and not for loss or impairment of seniority rights while remaining in service. (Page 4, *infra*.)

(2) **No claim upon which relief can be granted is stated, when the complaint fails to plead facts sufficient to show that defendant has committed a legal wrong, because the *Federal Rules of Civil Procedure* do not sanction the practice of pleading without essential details. (Page 7, *infra*.)**

(3) **The complaint fails to allege facts sufficient to show that defendant breached any contractual right of plaintiff, because it does not allege any contract, nor substantial performance, nor offer to perform on plaintiff's part, nor any breach of contractual duty. (Page 11, *infra*.)**

(4) **The complaint fails to allege facts sufficient to show that defendant committed any tortious wrong, because it attempts to state a claim, not for wrongful interference by a third party, but against the employer, without showing any duty on the employer's part to retain the employee in service, and showing on its face that plaintiff was discharged for cause of his failure and refusal to work. (Page 13, *infra*.)**

(5) **It appears from the face of the complaint that Section 43-1508, Arizona Code Annotated, 1939, is inapplicable, because the letter of the law does not reasonably include the state of facts alleged, and for the further reasons that it purports to make illegal any encouragement, aid or assistance to an employee engaged in political activities, and is intended to safeguard elections for the public benefit only. (Page 20, *infra*.)**

(6) If Section 43-1508, Arizona Code Annotated, 1939, should be construed as applicable, then it would deny to defendant due process of law and the equal protection of the laws, contrary to the Fourteenth Amendment to the Constitution of the United States and contrary to the Constitution of the State of Arizona, in that it would be so vague and uncertain as to be wholly speculative in scope and operation, and would constitute an unwarranted interference with the right and liberty of contract, and would discriminate unreasonably against corporations in favor of individuals and associations of individuals. (Page 27, *infra*.)

### ARGUMENT

- (1) **No legitimate issue exists as to seniority rights or as to exemplary damages.**

The motion to dismiss challenged the sufficiency of the complaint to state a claim upon which relief can be granted. It had no application to such questions as to the measure of relief, nor as to how that measure was pleaded, should it appear from the complaint that an actionable claim was stated. Yet plaintiff devotes extensive argument applicable solely to the measure of damages.

Plaintiff's argument under his proposition (b) is devoted almost exclusively to the contention that seniority rights are property rights (Br. 18 to 23). Unquestionably, such rights, if shown to exist, are valuable rights for the wrongful destruction of which an action will lie. Here, however, plaintiff sues for alleged wrongful discharge from employment, not for destruction or impairment of seniority rights while being retained in employment.

The Arizona case (Br. 18, 19) was instituted to determine and to restore seniority rights of existing employees under a collective labor agreement. The element of wrongful discharge was not present. The court stressed this distinction by pointing out that no unwilling employer was being required to employ certain individuals and that there was no attempt to interfere in the slightest degree with the employer's right to discharge, but only that the employer was required to live up to the contract of employment so long as it retained the individuals in service.

The group of cases cited at the top of page 20 hold that seniority rights arise out of the contract of employment—the collective labor agreement—and that individual employees, being bound by the collective agreement, are entitled to enforce seniority rights thereunder as under a contract made for their benefit, but they also hold that the union party to the agreement has the power by agreement with the employer to define, limit, modify or destroy such rights. Here, plaintiff pleads only Rule 39 of the collective labor agreement, and that it was not binding upon him (R. 5,6). He doesn't claim rights of seniority under the collective agreement, but denies its application. True, on this appeal he ignores those allegations, and under his proposition (a), which will be referred to hereinafter, seeks to invoke Rule 39 for his benefit. Assuming that this is permissible practice, his complaint is otherwise inadequate, for it does not plead the contract of employment, either in *haec verba* or in substance. To state a claim for loss of seniority rights, or of other employment benefits, the complaint must show a valid contract of employment, and a full statement of how and when such rights

were fixed and the conditions, nature and extent thereof.

*Austin v. Southern Pac. Co.*, (1942) 50 C. A. 2d 292, 123 P. 2d 39;

*Swank v. Young*, 60 Ariz. 18, 130 P. 2d 918;

*Davis v. Davis*, (1926), 197 Ind. 386, 151 N. E. 134.

Incidental to his argument to the effect that seniority rights are valuable property rights, plaintiff refers to two opinions of the Supreme Court of the United States holding that the right to work is protected by the Fourteenth Amendment to the Constitution of the United States (Br. 20, 21). These have no application for the reasons: first, that plaintiff has not invoked the protection of the Fourteenth Amendment, but only of the State Constitution and laws (R. 5, 7, 8); second, the Fourteenth Amendment may be invoked only as against state action; and, third, even an unlawful denial by state action of a right to seek or to obtain a state political office is not actionable under the Fourteenth Amendment. *Snowden v. Hughes*, (1944) 321 U. S. 1, 64 S. Ct. 397, 88 L. ed. 497.

Plaintiff's argument under his proposition (e), other than the axiomatic statement regarding compensatory damages, is exclusively devoted to a discussion of his alleged right to recover exemplary damages (Br. 37 to 40). These he seeks for alleged reckless disregard of contractual rights and for alleged inexcusable violation of the penal statute, and for the alleged conspiracy between the Brotherhood and defendant. In this respect, he overlooks the fact that exemplary damages are not to compensate for

injury, but constitute a penalty over and above actual damages, and that they cannot constitute the basis of a claim for relief, but are merely incidental to an actionable claim when stated and established.

*Collier v. Stamatis, Ariz.*, (1945) 162 P. 2d 125, 128.

*Alexander v. Jones, D. C. Okla.*, (1939) 29 F. S. 690;

25 C. J. S. 713, 714, Sec. 118.

- (2) **No claim upon which relief can be granted is stated, when the complaint fails to plead facts sufficient to show that defendant has committed a legal wrong.**

Plaintiff's chief contention is asserted under his proposition (f) to the effect that, under the *Federal Rules of Civil Procedure*, he is not required to allege facts sufficient to constitute a cause of action (Br. 40 to 43). He also asserts (Br. 43) that even if these rules were not in effect, the motion to dismiss (demurrer) should not have been sustained. In this latter respect, it is interesting to note that *Picking v. Pennsylvania R. Co.* deals with these rules, and that the two Supreme Court cases, which deal with the former Equity Rules, merely hold that when a bill of complaint (not a demurrer nor motion to dismiss) attacks a statute as being unconstitutional, it is inexpedient to determine grave constitutional questions on demurrer or motion to dismiss if there be reasonable likelihood that the production of evidence will make that answer to the question clearer.

Whether or not these rules require statement of a cause of action in the technical sense employed in

common law pleading is not important. Some of the cases cited by plaintiff either state or infer that such a statement is not required. On the other hand, the opinion in *Picking v. Pennsylvania R. Co.* (Br. 43) is replete with reference to a cause of action, and expressly holds that:

“ \* \* \* The plaintiffs have stated a valid cause of action rising under R. S. Section 1979 insofar as the individual defendants are concerned.”  
(151 F. 2d 249.)

Moreover, the Supreme Court of the United States, in *Gibbs v. Buck*, (1939) 307 U. S. 66, 59 S. Ct. 725, 83L. ed. 1111 has said:

“The motion to dismiss also presents generally the issue whether the bill states facts sufficient to constitute a cause of action. \* \* \* ” (307 U. S. 76.)

To the same effect is *American Viscose Corporation v. Rothensies*, 3 Cir., (1941) 121 F. 2d 186, 188.

Plaintiff cites cases from the 2nd, 3rd, 5th, 6th and 7th Circuits, and also one Supreme Court case which is not even remotely in point (Br. 41, 42). Most of these refer to *Leimer v. State Mut. Life Assur. Soc. Co.*, 8 Cir., (1940) 108 F. 2d 302, wherein, as is true of the cases cited, the court was concerned solely with the sufficiency of statement in a particular pleading. In the *Leimer* case, the issue arose as to the aptness of statement of facts to substantiate a legally sufficient statement of the claim, as is apparent from the court's language to the effect that the motion to dismiss for failure to state a claim takes the place of the former demurrer, and serves a useful purpose



when directed to a complaint based upon a wrong for which there is no remedy, or upon a claim which the complainant is without right to assert and for which no relief could possibly be granted to him, (108 F. 2d 305, 306).

Amongst the 5th Circuit cases cited by plaintiff, the opinion in *DeLoach v. Crowley's, Inc.*, points out that a complaint clearly without merit is subject to attack by a motion to dismiss, and that the want of merit may consist of absence of law to support the claim, or of facts sufficient to make a good claim, or in disclosure of facts which will necessarily defeat the claim.

*American Viscose Corporation v. Rothensies* and *Picking v. Pennsylvania R. Co.*, ante, illustrate how the 3rd Circuit has spoken on other occasions. In the former, the court states that the motion to dismiss is equivalent to a general demurrer, admitting facts well pleaded, and presenting the question whether or not the complaint states a cause of action and permitting the raising of a constitutional question.

One of the 7th Circuit cases cited, *Burley v. Elgin, J. & E. Ry.*, deals with a motion for summary judgment, but the opinion points out that the complaint stated a prima facie cause of action for violation of a collective labor agreement. In *Vilter Mfg. Co. v. Loring*, 7 Cir., (1943) 136 F. 2d 466, 468, the same court holds that the question presented by a motion to dismiss is whether the complaint states a cause of action.

No cases are cited from the 9th Circuit, and it is assumed that this court has not spoken on the subject. However, Rule 8(a), *Federal Rules of Civil Pro-*

*cedure*, requires the complaint to contain a short and plain statement of the claim *showing that the pleader is entitled to relief*, and *Rule 12 (b)* authorizes a motion to dismiss for failure to state a claim *upon which relief can be granted*. Certainly, no less than the express requirements of these rules is contemplated. These rules are identical with the rules of pleading in the State of Arizona, as set forth in *Sections 21-404 and 21-429, Arizona Code Annotated, 1939*. The Arizona Supreme Court construes them as requiring the complaint, as against a motion to dismiss, to state a cause of action in the code-pleading sense and disapproves a construction thereof which would open the door to pleadings without the essential details. *Malin v. Southern Pac. Co., (1944) 154 P. 2d 790*. A logical explanation of the effect of these rules is made in *Sutton v. Eastern Viavi Co., 7 Cir. (1943) 138 F. 2d 959, 960*, as follows:

“At the risk of undue prolixity, we refer to rules elementary in character and ancient in procedural law, but retained in modern practice. Under Rule 12(b) of Federal Rules of Civil Procedure, 28 U. S. C. A. following section 723c, failure to state a complaint upon which relief can be granted can result only in allowance of a motion to dismiss. No claim for relief is stated if the complaint pleads facts insufficient to show that a legal wrong has been committed, or omits an averment necessary to establish the wrong or fails to so link the parties with the wrong as to entitle the plaintiff to redress. \* \* \* ”

Tested by the language of the rules, or by any announced judicial construction thereof, plaintiff's

complaint does not state a claim against defendant upon which relief can be granted.

- (3) The complaint fails to plead facts sufficient to show that defendant breached any contractual right of defendant.**

Plaintiff does not allege any contract of employment. He does not allege any breach by defendant of any right founded upon contract. The only recitals bearing upon contract concern Rule 39 of the collective labor agreement, which rule relates to leave of absence only insofar as seniority rights are concerned, and as to which he alleges the same was not binding upon him. In view of his allegations, and for the further reason that most of the legal principles which govern this controversy are applicable in tort as well as in contract, the only justification for this separate treatment of the contract angle is the confusion injected by plaintiff's specification of error No. III, and in his statement No. 2 of points relied upon, and in his argument under his proposition (a), (Br. 10, 11; 14 to 17; R. 33).

In this argument, plaintiff concedes that defendant was bound by the collective agreement, and that he, likewise, was bound thereby, and he cites cases (Br. 16, 17) which support such concession and which also uphold the right of an employee in service after the adoption of such an agreement to sue upon that agreement. Then he indulges in the fallacy of contending that Rule 39 imposed an obligation on defendant's part to grant his request for extended leave of absence and that he was prematurely discharged under Rule 39.

The argument is inconsistent with his pleadings in several respects. Rule 39 deals only with seniority rights, not with duration or termination of service. He alleges that it had no binding effect upon him. Rule 39 does not even purport to require defendant to retain anyone in its service, nor to require defendant to grant or to extend leave of absence for illness, or otherwise. Rule 39 leaves it optional with defendant to grant leave of absence, or to extend such leave, subject only to the qualification that seniority rights will be jeopardized in the event of a grant of extended leave for longer than ninety days for cause other than illness, unless arranged for by agreement between defendant and the Brotherhood. Plaintiff does not allege, nor show that he endeavored to secure extended leave in the manner specified by Rule 39.

For all of these reasons, and because nothing in the record justifies his argument, there is no logic nor merit in his unqualified statements that "plaintiff was entitled, in all events, to leave of absence without limitation of time because of illness", and that defendant was "required" to start his leave on March 29, 1944, and that "defendant prematurely discharged plaintiff" (Br. 17).

*McGlohn v. Gulf S. I. R. R.* (Br. 16), is illustrative of the group of cases cited. It deals only with the collective labor agreement and holds it is in the nature of rules governing the employment and that neither it nor any individual employment governed thereby is terminable save in the manner therein prescribed. It is worthy to note that the complainant pleaded a contract of employment, performance on his part, with fidelity and dispatch, his willing-

ness to continue such performance, his working terms and the seniority rules.

Plaintiff clearly understands that, whatsoever application Rule 39 may have, it does not impose any positive duty upon defendant, for he alleges that he "obtained a leave of absence", and defendant "granted" a ninety-day leave, and he "requested an extension" thereof, (R. 4; Br. 14 to 17).

- (4) **The complaint fails to allege facts sufficient to show that defendant committed any tortious wrong.**

(a) **General consideration.**

That plaintiff sought to state a claim in tort, appears not only from the allegation of his complaint, but also from his specification of error No. IV, his statement No. 3 (a) of points relied upon, and his argument, and particularly his proposition (e), which he connects with all specifications of error (Br. 12 to 14; 23 to 27; 37).

This is not an action against the Brotherhood, nor some other third party, for wrongful interference with the employment relationship. The Brotherhood is not even a party to the suit. If the Brotherhood were the defendant, and if it were shown to be guilty of wrongful acts which were not committed in the legitimate exercise of its own rights, and which induced the employer to deprive the employee of seniority rights or to discharge him from service, it would be answerable in tort in a proper case.

Wrongful discharge, even pursuant to malicious motive, unaccompanied by an act of trespass with

force, does not form the basis of a tort action by an employee against his employer.

*Elmore v. Atlantic Coast Line R. Co.*, (1926)  
191 N. C. 182, 131 S. E. 633;

*May v. Tide Water Power Co.*, (1929) 246 N. C.  
439; 5 S. E. 2d 308;

*Manley v. Exposition Cotton Mills*, (1933), 47  
Ga. App. 496, 170 S. E. 711.

These cases also hold that, unless a definite period of time extending beyond the date of discharge, is provided in the employment contract, that contract is terminable at the will of either party thereto without liability to the other contracting party. This is the general rule, regardless of whether the suit sounds in contract or in tort. Illustrative of its application to an action in contract is *Louisville & N. R. Co. v. Wells*, (1942) 289 Ky. 700, 160 S. W. 2d 16; illustrative of its application to an action in tort are:

*Bell v. Faulkner*, Mo. App., (1934) 75 S. W. 2d  
612;

*Clark v. Cincinnati N. O. & T. P. Ry Co.*, (1935)  
285 Ky. 197, 79 S. W. 2d 704;

*Speegle v. Board of Fire Underwriters*, (1945)  
C. A. 2d, 158 P. 2d 426.

Plaintiff does not plead the contract of employment, nor any obligation on defendant's part to retain him in service for any fixed period of time. He merely pleads (and then only incidental to the matter of seniority rights) that, at the time of his discharge, he had been employed by defendant for approximately twenty-seven years and that he had ac-

cumulated valuable seniority rights of which he was deprived when discharged, (R. 8, 9).

Plaintiff quotes from *35 Am. Jur. (Master and Servant), Sec. 19, p. 456* to the effect that where no definite term of employment is expressed, there is no inflexible rule governing the duration of the relationship, and that if the contract was made with reference to a general custom or business usage, it is not indefinite as to duration if such custom or usage fixes the term (Br. 22). The object of so quoting is not apparent, for the plaintiff pleads no general custom nor business usage, and the quotation is followed by the following:

“ \* \* \* According to the general rule as laid down by a majority of the courts, however, contracts of employment which mention no period of duration, which are in a true sense indefinite and without stipulation for an implied minimum period, are deemed terminable at will of either party; and the burden of proving the contrary must be assumed by the party who asserts that the employee is engaged for a definite period.  
\* \* \* ” (*35 Am. Jur. 457, 458, Sec. 19.*)

In *Clark v. Cincinnati, N. O. & T. P. Ry. Co., ante*, the court, in sustaining a demurrer to a complaint filed by a railroad section hand, alleging that the railroad employer and its agents wrongfully discharged him, said:

“The petition here attempts to set up nothing more nor less than an action for damages. It does not contain sufficient averments to allow the court to consider a plea for a restoration of appellant’s former position. The prayer of the

petition exemplifies the lack of pleading looking to any such relief. Damages are sought in the sum of \$750 for loss of appellant's job as section hand for more than five years, in addition to incidental rights and privileges 'under Rules and Regulations of the defendant railway company'. In order to sustain a claim for damages for the wrongful discharge of an employee, it should be made to appear that a valid contract for such employment in fact existed at the time of his discharge. It should be shown that such contract was entered into for a definite period of time; and likewise should show obligation on the part of the employee to render service for a fixed period and reciprocal obligation on the employer's part to retain the employee's services. \* \* \* " (79 S. W. 2d 706.)

In *Speegle v. Board of Fire Underwriters*, ante, the court sustained a demurrer to a complaint for wrongful interference with insurance agency contracts, on the ground that an allegation of "permanent" employment amounts to an allegation of employment of indefinite time, terminable at will.

Plaintiff's allegations on information and belief that defendant and the Brotherhood, through officers and agents, conspired to deprive plaintiff of the opportunity to seek public office (R. 9, 10), add nothing to his complaint. The names or identities of such officers and agents are not disclosed, and there is no allegation that any act was done pursuant to the alleged conspiracy which would result in liability here. Confederation and conspiracy cannot charge an actionable wrong, if actionable wrong is not otherwise alleged.



*Johnson v. East Boston Sav. Bank*, (1935) 290 Mass. 441, 195 N. E. 727;

*Lambert v. Georgia Power Co.*, (1936) 181 Ga. 624, 183 S. E. 814;

*State of Missouri v. Fidelity & Casualty Co.*, 8 Cir., (1939) 107 F. 2d 343;

*Savage v. Western Union Telegraph Co.*, (1945) 32 S. E. 2d 785;

*Speegle v. Board of Fire Underwriters*, ante.

In *Johnson v. East Boston Sav. Bank* a demurrer was sustained to a complaint filed by a bank clerk, seeking to hold several defendants liable in tort for alleged illegal conduct pursuant to conspiracy by making it appear that he was discharged for dishonesty. The court applied the general rules that an action in tort would not lie against the bank for wrongful discharge, and that an act which affords no ground for action in tort if done by one person, is not actionable if done by several persons pursuant to conspiracy.

In *Lambert v. Georgia Power Co.* a demurrer was sustained to a complaint against an employer and a labor union, charging wrongful discharge pursuant to a conspiracy, because the complaint failed to allege a fixed term of employment and because conspiracy, although wrongful in motive, to effect what one has a legal right to do is not actionable.

It may be that the allegations as to conspiracy were inserted only for the purpose of laying a foundation for punitive damages, as is indicated from the fact that it is only in connection with such mat-

ter that plaintiff mentions such allegations, (Br. 39, 40).

(b) **It appears from the face of the complaint that defendant was discharged for cause.**

Plaintiff does not allege, nor does he argue that he was discharged while rendering service, or even part-time service, in the duties of his employment. His complaint is that he was discharged for failure to report for duty after being ordered to do so (R. 4). He infers that defendant's order was pursuant to Rule 39 of the collective labor agreement (R. 4), but Rule 39 (R. 5) pertains to seniority rights. He alleges Rule 810 of defendant's General Rules and Regulations (which rule he does not endeavor to tie in with the collective agreement), as follows:

"Employees must not engage in any other business without permission from proper officer. They must report for duty at the prescribed time and place and devote themselves exclusively to their duties during prescribed hours." (R. 6; Br. 7.)

This rule and defendant's instruction to plaintiff to report for duty were reasonable, and it was plaintiff's duty to heed and to follow them. The employee's services during business days and hours belong to his employer, *35 Am. Jur. 515, 516, Sec. 85*. A contract of employment presupposes that the employee will continue to make substantial performance, *Bank of America Nat. Trust & Sav. Ass'n., etc., v. Republic Productions, Inc., (1941) 44 C. A. 2d 651, 112 P. 2d 972*. The employee's promise to comply with all reasonable rules governing his employment is implied, *Adams v. Southern Pac. Co., (1928)*

204 Cal. 63, 266 P. 541, 57 A .L. R. 1066. It must be deemed that an employee was rightfully discharged, where it appears that he was unable or unwilling to devote his time and attention to his duties, 35 Am. Jur. 481, Sec. 49.

Plaintiff's allegations are quite similar to the situation which confronted the Missouri Supreme Court on the pleadings and the evidence in *Joslin v. Chicago, M. & St. P. Ry. Co.*, (1928) 319 Mo. 250, 3 S. W. 2d 352. There an engineer for one railroad sued another railroad in tort, praying for compensatory and punitive damages, for inducing his employer to discharge him by threat of denial to his employer of use of the inducer's tracks. Judgment in his favor was reversed on the ground that, under the pleadings and the evidence, verdict should have been directed for the employer. In so doing, the court said:

“ \* \* \* On March 11, 1924, Superintendent Moore advised plaintiff by letter that his request for an extension of his leave of absence was inconsistent, and notified plaintiff that ‘it will be necessary for you to report for duty if you expect to retain your seniority’. Plaintiff failing to report for duty in compliance with the written instruction and order of Superintendent Moore, that officer finally dismissed plaintiff from the service of the employer railroad company on April 20, 1924, several weeks after the commencement of his action against the defendants herein. The evidence is positive and conclusive that plaintiff's final and ultimate discharge and dismissal from the service of his employer was occasioned solely by reason of his

failure to report for duty under the instructions of his superintendent, Moore, conveyed to him by letter on or about March 11, 1924. Had plaintiff reported for duty pursuant to such instructions, he apparently would have preserved and maintained his seniority rights as an engineer, and, so far as the record before us discloses, plaintiff would have been retained in the service of the Missouri, Kansas & Texas Railway Company." (3 S. W. 2d 364.)

It appears from plaintiff's complaint that he did not perform, nor offer to perform substantially, or at all, the duties of his employment, that he disregarded and refused to comply with a reasonable rule of his employment and with his employer's reasonable instructions, and that, in lieu of performance and compliance, he elected to devote all of his time, talents and energies to the conduct of his political campaign. This was a breach by plaintiff of such contract of employment as may have existed. That breach warranted his dismissal from service, and he was discharged by reason thereof.

- (5) **It appears from the face of the complaint that Section 43-1508, Arizona Code Annotated, 1939, is inapplicable.**

The Arizona statute invoked by plaintiff—*Section 43-1508, Arizona Code Annotated, 1939*,—makes it a misdemeanor for a corporation employer to influence the ballot of an employee, or to contribute to an employee holding public office, or to "*encourage, aid, or assist an employee in running for public office*", or to "*make, enforce, or attempt to enforce any order, rule or regulation, or adopt any other device or*

*method*”, to prevent an employee from engaging in political activities, or from running for, or holding public office. It is a penal statute, apparently enacted to safeguard elections, and is contained in *Article 15, Chapter 43, of the Code*, entitled “Elections”. It is prohibitive in nature, and does not impose any affirmative duty upon the corporation. It purports to prohibit encouragement, aid or assistance to an employee seeking office just as it purports to prohibit the enforcement of a device to prevent one from seeking office, and to impose a penalty no less severe in the one case than in the other. It does not expressly vest any right of civil action in an employee, or others, for violation of its prohibitions. It has not been construed by the Arizona Supreme Court.

Plaintiff invokes the statute, by allegations to the effect that he was wrongfully discharged in violation of his rights thereunder (R. 6 to 8). This vague conclusion is not clarified by his argument, for when he discusses his specification of error No. IV (Br. 12), under his propositions (c) and (d), he merely makes the bold assertion that he was discharged in direct violation of the statute (Br. 24), and then confines his attention to his contentions that the statute does not violate the Constitution of the United States and should be so construed as to permit a civil remedy (Br. 23 to 27).

It must be assumed, therefore, that he invokes such portion of the statute which purportedly prohibits a device to prevent him from running for office, and that it is his contention that either Rule 39 of the collective labor agreement, or defendant’s General Rule 810, or both of them, constituted the device.

Neither Rule 39 nor General Rule 810, the former dealing with seniority rights and the latter dealing with service during business hours, purports, or can be construed to be a device or method to interfere with political activities. Both are reasonable rules of employment. Rule 39, as shown hereinbefore, does not relate to term or termination of service, and General Rule 810 merely requires employees to report for duty and to devote themselves exclusively to that duty during business hours. Had defendant granted extended leave of absence to plaintiff under Rule 39, or otherwise, upon his application "*to conduct and continue his campaign*" (R. 3; Br. 5), it would have offended that portion of the statute against rendering encouragement, aid or assistance. It cannot be assumed, and plaintiff does not allege that he was required to devote the whole of his time and energies, or to refuse to report for duty when so ordered, or to remain absent during business hours, in the conduct of his political campaign, and so General Rule 810 cannot be held to infringe the statute.

Furthermore, it appears from the allegations of the complaint and from facts which will be judicially noticed that plaintiff was not discharged until September 28, 1944, (R. 3, 4, 8, 9), and that he was not prevented from engaging in political activities, or accepting candidacy for office, or from conducting his campaign; he did engage in such activities during that part of 1944 referred to in his complaint and did accept candidacy on the Democratic ticket for nomination to the office of Governor of the State of Arizona, and did conduct and continue his campaign for nomination until he was defeated and an-

other candidate was duly nominated on said ticket for said office by the voters of the State at the State primary election held and determined on July 18, 1944, all prior to the date of his discharge from defendant's employ.

*Brown v. Piper*, (1875) 91 U. S. 37, 23 L. ed. 200;

*Richardson v. McChesney*, (1910) 218 U. S. 487, 31 S. Ct. 43, 54 L. ed. 1121;

*Picking v. Pennsylvania R. Co.*, (Br. 43);

*Louisiana Farmers' P. U. v. Great Atlantic & Pacific T. Co.*, D. Ct. Ark., (1941) 40 F. S. 897.

There is no language in *Section 43-1508*, which would lend support to the contention that the discharge of an employee, under no fixed term of employment and for cause of his failure and refusal to report for duty, or to render substantial service, when so required by reasonable rule and order, amounts to a violation which would authorize him to sue for damages. If there were, then, as said by the Supreme Court in *Church of the Holy Trinity v. United States*, (1892) 143 U. S. 457, 472, 12 S. Ct. 511, 36 L. ed. 226 (construing a Federal law against contracting aliens):

“ \* \* \* It is the duty of the courts, under those circumstances, to say that however broad the language of the statute may be, the act, although within the letter, is not within the intention of the Legislature, and therefore cannot be within the statute.”

The letter of the law does not *reasonably* include the state of facts and conclusions stated in the complaint.

The Arizona statute governing the construction of *Section 43-1508* is set forth in *Section 43-102, Article 1, Chapter 43*, of the Code, and reads as follows:

**"43-102. How construed.** The provisions of this Code, so far as they are substantially the same as existing statutes, shall be construed as continuations thereof, and not as new enactments. The rule of the common law that penal statutes are to be strictly construed, has no application to this Code; *its provisions are to be construed according to the fair import of their terms, with a view to effect its object and to promote justice.* No part of this code is retroactive, unless expressly so declared." (*Emphasis supplied.*)

Although the common law rule of strict construction is not to be applied, the courts are not permitted to extend the language of *Section 43-1508* by implication. In this respect, the Arizona Supreme Court, in *State v. Behringer, (1918) 19 Ariz. 502, 172 P. 660, 661*, involving a criminal prosecution for wire-tapping, said:

"It is urged by the prosecution that under a liberal construction, which is not only authorized, but enjoined, in construing penal statutes (section 5, Penal Code), section 692 would cover the acts alleged in the information. If by a 'liberal construction' it is meant that the courts can extend the meaning of the language used by the Legislature to include all cognate or related acts to those actually condemned, the contention is plausible; but, as we view it, we are not permitted to go that far. *If the letter of the law clearly excludes the state of facts propounded*



*in the pleading, or does not reasonably include them, even though they be within the reason and policy of the legislation, the courts cannot, by implication or construction, declare a person charged with them guilty of a crime. \* \* \**”  
(*Emphasis supplied.*)

There is serious doubt, assuming for the sake of argument that the letter of the law does include the state of facts and conclusions stated in the complaint and is valid, that *Section 43-1508* can be invoked here, or is within the argument and line of cases cited by plaintiff (Br. 32 to 37). It imposes no duty, gives no right of action, and is designed, at least primarily, for the benefit of the public.

In *Cheek v. Prudential Insurance Co.*, relied upon extensively by plaintiff (Br. 32 to 36), the statute under consideration, rather than being purely prohibitive in language, imposed a positive duty upon the corporation, which duty the court regarded as for the benefit of a class of individuals, of which class the complainant was a member. In *Lockheed Aircraft Corporation v. Superior Court, etc.* (Br. 36), the statute discussed specifically provided that nothing therein should prevent an injured employee from recovering damages.

Notwithstanding the Missouri Supreme Court's opinion in the *Cheek* case, the Missouri Appellate Court, in a later case, *Bell v. Faulkner, Mo. App., (1934) 75 S. W. 2d 612*, reversed a judgment recovered by a dairy employee against the dairy for compensatory and punitive damages for alleged wrongful discharge under a statute making it unlawful for officers and agents of officers and agents of a corpora-

tion to coerce or to intimidate its employees in voting for any candidate. Reversal was due to the error of the lower court to instruct the jury that the employer had the right, without subjecting itself to civil liability, to discharge, with or without cause, an employee who did not serve under a contract of employment for a definite term. The appellee, relying upon the *Cheek* case, contended on appeal that his discharge was a direct violation of the statute, and that it should be construed so as to authorize a civil action, but the court disposed of this contention by an analysis of the distinction between the statutes involved; in the *Cheek* case imposing a positive duty to provide service letters at time of termination of service, and in the *Faulkner* case, prohibiting coercion and intimidation in voting.

The *Faulkner* case is only slightly weakened as a precedent, by the circumstances there that the statute made only the act of the corporation's agents and officers unlawful, and imposed only a penalty of imprisonment.

In the *Lockheed* case, the question was whether or not a peremptory writ of prohibition should issue against proceedings under a subpoena duces tecum. The pleadings referred to provisions of the California Labor Code, somewhat similar to *Section 43-1508, Arizona Code Annotated, 1939*, but pertaining more particularly to "labor" than to "elections", and containing no prohibition against encouragement, aid or assistance as in the Arizona statute. The rules, regulations and policies of Lockheed which were challenged in the complaint are not set out in the opinion, and the court found that they "manifestly" contra-

vened the Labor Code, whereas the Southern Pacific Company rules pleaded in the instant case cannot, reasonably, be found "manifestly" nor remotely to violate the Election law.

- (6) **If Section 43-1508, Arizona Code Annotated, 1939, should be construed as applicable, then it would deny to defendant due process of law and equal protection of the laws, contrary to the Fourteenth Amendment to the Constitution of the United States and to the Constitution of the State of Arizona.**

(a) **Denial of due process of law.**

To read into *Section 43-1508* a legislative intention to make it unlawful for a corporation employer to discharge an employee for failure and refusal to render substantial performance when so required by employment rules of general application, or even to make it unlawful for the employer <sup>to refuse</sup> to grant, or to extend leave of absence to an employee electing to devote all of his time and efforts to the conduct of a political campaign, would offend the due process clauses of the United States Constitution and the Constitution of the State of Arizona in two particulars: The statute would be so vague and uncertain in its application as to require the employer, at its peril, to speculate as to its meaning; and it would constitute an unwarranted interference with its right and liberty of contract.

(i) Under elementary principles of law previously stated herein, the employment relationship imposes an obligation upon the employee to make substantial performance and to comply with all reasonable rules governing the employment, just as it imposes certain

obligations upon the employer, and, where it appears that he is either unable or unwilling to devote his time and attention to his duties, he may be discharged without liability on the part of the employer. The act of discharge, under such circumstances, has never been regarded as reprehensible. To hold that such an act becomes reprehensible when done subsequent to a denial of leave of absence to conduct a political campaign, especially in view of the condemnation of the statute against encouraging, aiding or assisting an employee in running for office, would place the corporation in a confused and perilous situation. It would not have any idea as to what policies, acts and employment rules would be permissible, and it would, in formulating policies, adopting rules and performing acts, proceed at peril of prosecution and civil suit.

The Arizona statute, even without such a forced and strained interpretation, is vague as to what orders, rules or regulations will constitute a device or method to prevent employees from engaging in political activities, <sup>and</sup> it prescribes no standard, ~~as~~ as to what conduct will constitute rendering encouragement, aid and assistance. It is unlike the provision of the Labor Code discussed in the *Lockheed* case (Br. 36), which does not purport to penalize encouragement, aid or assistance, and which the California Appellate Court regarded as sufficiently definite that people of common sense and reason would experience no difficulty in determining with a reasonable degree of certainty what was intended by the Legislature.

Here, we find that at least as early as 1940 rules of employment were adopted, limiting defendant's

right to grant or to extend leave of absence without jeopardizing seniority rights, and requiring all employees to report for and devote themselves to duty during business hours. There was nothing in *Section 43-1508* which would indicate to defendant that these rules would be held to be unlawful for not containing exceptions to cover political activities. In 1944 plaintiff, one of its employees, announces that he is a candidate for public office, and requests leave of absence to conduct his campaign. Rule 39 neither required nor prohibited defendant to grant such request, but it placed plaintiff in jeopardy of preserving seniority rights if the request were granted. General Rule 810 required all employees to work during business hours, but had no application as to plaintiff at other times. *Section 43-1508* apparently made it unlawful to grant extended leave for such purpose. Leave of absence for the purpose was denied, and plaintiff was instructed to return to work. He failed and refused to do so, and thereby disregarded the employment rules and his employer's orders. He devoted all of his time and efforts to that campaign, or at least to some object other than his employment duties, and failed to attain nomination to office on July 18, 1944. Thereafter, on September 28, 1944, he was discharged. There was nothing in the language of *Section 43-1508* to indicate that this was unlawful, or would subject defendant to civil or criminal liability therefor.

It is not necessary to consider whether or not *Section 43-1508* is definite and certain and sufficiently explicit to have informed defendant what conduct on its part would be unlawful, or whether or not *Section 43-1508* is unlike the statute stricken down in

*State v. Menderson*, as asserted in plaintiff's argument (Br. 30). The issue at this point arises over the validity of *Section 43-1508*, if construed to be applicable to the facts of this case. The statute in the *Menderson* case purported to make it felonious for an employer to discharge an employee for membership in any organization, without expressly mentioning a labor union. A demurrer was sustained to an information charging that Menderson discharged an employee because of the latter's union affiliation, on the ground that the statute under which the prosecution was instituted was, by reason of vagueness and uncertainty, repugnant to the due process clauses of the Federal and State Constitutions. In so doing, the Arizona Supreme Court found that some of the things therein forbidden were within the legislative power, while others were not, that the act charged in the information fell within the literal language of the statute, and it held that when the Legislature declares an offense in words of indeterminate signification, or when its language is so general and indefinite that it may embrace acts commonly recognized as reprehensible as well as other acts which are not to be presumed to be made unlawful, it denies due process of law to those who are entitled to be informed in advance of action as to what is commanded or forbidden, as no one can be required at peril of liberty and property to speculate in advance as to the scope and meaning of a penal statute, *State v. Menderson*, (1941) 57 Ariz. 103, 111 P. 2d 622. These are some of the principles invoked by defendant in its motion to dismiss.

(ii) Freedom of contract, as to terms, conditions and duration of employment, is the rule, and lawful

state interference is the exception. The Supreme Court cases of *Prudential Insurance Co. v. Cheek* and *Chicago, R. I. & P. Co. v. Perry*, cited by plaintiff (Br. 25 to 29) affirm this principle, and merely apply the exception under the facts there presented. The analogy between those cases and the situation here presented is only that the complainants invoked penal statutes directed to the employment relationship. The statutes were not vague and uncertain; they imposed a positive duty upon the corporation employer; that duty was to supply to the employee, upon termination of service, a letter worded as it saw fit, setting forth the employee's name and character, the duration of his service, and the ground of termination of employment; they imposed no obstacle or interference in the making or termination of employment contracts, and did not purport to require the employer to retain anyone in service nor to prevent it from dismissing an employee, with or without cause. Action was instituted, in the former case, because the employer refused to supply such a letter, and in the latter case, because the employer made false statements in a letter so supplied. The Supreme Court announced that it was not disposed to question that freedom of contract in the employment relationship is an elementary part of the rights of personal liberty and private property, not to be stricken down directly, nor arbitrarily interfered with, but that the statutes there in question did not constitute either a serious or an arbitrary interference with such freedom of contract.

Plaintiff suggests, in connection with quotations supplied from the opinions in the foregoing cases,

that the privilege of becoming a candidate for public office is a higher right than the right to receive a service letter (Br. 29). However, he was not denied that privilege, and he doesn't even allege such to be the case. A more pertinent suggestion would be that the employer's right to discharge a disobedient employee, not hired for a fixed term, is a higher right than its desire to withhold information regarding the services rendered by an employee.

The opinion of the Supreme Court of Illinois, in *People v. Chicago, M. & St. P. Ry. Co.*, (1923) 306 Ill. 486, 138 N. E. 155, 28 A. L. R. 610, although not dealing with the subject of discharge from employment, upholds the doctrine that the state cannot interfere in a private employment, to the extent of prescribing the terms of service to be rendered by an employee to his employer. The court quashed an information charging an employer with deducting from an employee's wages for time lost during absence for voting at an election, although the statute purported to make it a misdemeanor to do so. The statute was held to be an unreasonable abridgment of the right of contract, and in direct conflict with the due process and equal protection clauses of the Federal and State Constitutions. The following observation in the opinion is both logical and here apropos:

“ \* \* \* The Legislature had just as much right to require employers to pay their employees for the time they necessarily would be compelled to use in looking after any sick member or members of their family as it had to pass the provision in question. Other striking examples of



void legislation of the character in question might be stated, and in which it would appear that the employee would be engaged in a matter of pursuit equally as commendable and as essential to his own personal welfare; but further comment is unnecessary, as it is entirely clear that the provision in question is an unreasonable abridgment of the right to contract, and therefore void." (138 N. E. 157).

**(b) Denial of equal protection of the laws.**

If *Section 43-1508* should be construed as applicable, then it would be repugnant to the <sup>equal</sup> protection clause of the Fourteenth Amendment, and to provisions of similar purport in the Constitution of Arizona (R. 24, 25).

Under the Federal and State Constitutions, corporations may not be singled out arbitrarily so as to be subjected to burdens and perils to which individuals, firms, partnerships and associations would as appropriately be subject but which are exempt from the operation of a state statute. Legislation which is directed solely to corporations, and which eliminates from its scope individuals or associations of individuals where there is no reasonable basis for discrimination, is invalid. No citation of authority is required as to the effect of the Fourteenth Amendment on such legislation. The purpose of the State Constitution's provisions which are invoked is to secure equality of opportunity and right to all persons similarly situated.

*Prescott Courier v. Moore*, (1929) 35 *Ariz.* 26,  
274 *P.* 163, 165;

*Begay v. Sawtelle*, (1939) 53 *Ariz.* 304, 88 *P.* 2d  
999;

*Elliott v. State*, (1926) 29 *Ariz.* 389, 242 *P.* 340.

The Tennessee Supreme Court in *State v. Nashville, C. & St. L. Ry. Co.*, (1911) 214 *Tenn.* 16, 135 *S. W.* 773, *Ann. Cas.* 1912 *D* 805, held that a statute, which made it a misdemeanor for any corporation, or its officers or agents, to discharge or to threaten to discharge an employee for voting or not voting for or against any candidate or measure, or for trading or not trading with any person or class of persons, but which did not apply to firms or individuals, was arbitrary and vicious class legislation, a grant of a special right, privilege, or immunity, a denial of this equal protection of the laws, and in contravention of the Fourteenth Amendment and of provisions in the Tennessee Constitution virtually identical with the provisions of the Constitution of Arizona here invoked.

The Arizona statute, by its terms, applies exclusively to "any corporation, its officers, or agents." No mention is made of associations, labor unions, co-operatives, firms or partnerships, constituting groups of individuals, or even of individuals (other than officers and agents of corporations). So far as the statute reads, such groups of individuals, and their officers and agents, and individuals, may do with impunity any or all of the things therein made

unlawful when done by corporations. They can, for instance, make and enforce orders, rules or regulations, or adopt other devices or methods to prevent an employee from engaging in political activities, or assuming the conduct of any political campaign, and they can instigate, aid or assist, whether by personal service or contributing money or anything of value, any employee to run for office, and they can also influence his ballot and contribute to him while he is engaged in the official duties of a public office. The statute, on its face, appears to be clear denial of the equal protection of the laws to corporations and their officers and agents, as there is no reasonable basis of classification between them and individuals and associations of individuals having equal, or greater strength under a non-incorporated form of organization. To go beyond the acts purportedly made unlawful therein, so as to read into it a legislative intention to include the circumstances set forth in plaintiff's complaint, would require every corporation to proceed at its peril, in virtually every move undertaken in or incidental to its employees, or any of them, to determine absolutely that there are no political implications directly or indirectly involved. Such construction would deny to defendant the equal protection of the laws of the State of Arizona.

### CONCLUSION

Plaintiff's complaint failed to state a claim against defendant upon which relief could be granted. It was appropriately challenged by defendant's motion to dismiss. The motion was granted. Plaintiff

elected to stand upon his complaint and refused to attempt a better statement. Judgment of dismissal was duly entered. For these reasons, defendant respectfully submits that the judgment of the District Court should be affirmed.

Respectfully submitted,

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